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# Ontario Energy Board

Ontario

REFERENCE FROM THE
LIEUTENANT GOVERNOR
IN COUNCIL

## ICG Utilities (Ontario) Ltd

**Cogeneration Project**
**Boise Cascade Canada Ltd.**
**Fort Frances**

**E.B.R.L.G. 33**

# REPORT OF THE BOARD

Pour des renseignements en français, veuillez communiquer avec la Commission de l'énergie de l'Ontario.

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## ICG Utilities (Ontario) Ltd

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**Fort Frances**

**E.B.R.L.G. 33**

# REPORT OF THE BOARD

IN THE MATTER OF the Ontario Energy Board Act, R.S.O. 1980, Chapter 332, and in particular Sections 26 and 36 thereof;

AND IN THE MATTER OF a reference to the Ontario Energy Board by the Lieutenant Governor in Council, under Section 36 of the Ontario Energy Board Act, in respect of a proposal by ICG Utilities (Ontario) Ltd to construct a cogeneration facility on the property of Boise Cascade Canada Ltd. in the Town of Fort Frances, Ontario, and to hold such facility as a Division of ICG Utilities (Ontario) Ltd as owners of the facility.

BEFORE: R.M.R. Higgin
Presiding Member

D.A. Dean
Member

V.W. Bielski, Q.C.
Member

December 21, 1989

# REPORT OF THE BOARD

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Ontario

Ontario Energy Board
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December 21, 1989

To His Honour the Lieutenant Governor in Council

By Order in Council OC 1499/89, dated June 12, 1989, the Ontario Energy Board was directed to hold a public hearing and to report on certain matters respecting the proposed investment by ICG Utilities (Ontario) Ltd in a cogeneration project situated on the premises of Boise Cascade Canada Ltd. in the Town of Fort Frances, Ontario.

The Board herewith submits its Report and Recommendations.

Respectfully Submitted

ONTARIO ENERGY BOARD

R.M.R. Higgin
Presiding Member

D.A. Dean
Member

V.W. Bielski, Q.C.
Member

## Table of Contents


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PAGE

## SUMMARY OF BOARD RECOMMENDATIONS

1. The Board recommends that the Lieutenant Governor in Council formally grant the request from ICG Utilities (Ontario) Ltd for an exemption to Article 5.4 of the 1988 Undertakings to allow it to invest in the 100MW cogeneration project situated on the premises of Boise Cascade Canada Ltd. in the town of Fort Frances, Ontario. This dispensation to be made conditional upon ICG Utilities (Ontario) Ltd, its shareholders and parent Companies which control ICG Utilities (Ontario) Ltd:

   a) executing an amendment to Article 5.4(c) of the 1988 Undertakings which will require ICG Utilities (Ontario) Ltd to obtain dispensation of the Lieutenant Governor in Council, upon recommendation of the Board, for any new non-utility investment. 'Dispensation' means prior approval i.e., before any binding contractual obligations are entered into by ICG Utilities (Ontario) Ltd, its parent companies and affiliates, or any funds are expended other than for project feasibility assessment.

(b) as soon as possible, by a date to be agreed with the Lieutenant Governor in Council, establishing the cogeneration project in a legally and financially separate corporate entity which may be owned by ICG Utilities (Ontario) Ltd, rather than as an operating Division of the utility company.

(c) executing an undertaking to indemnify the regulated utility and its ratepayers against all direct and indirect liabilities and any additional costs arising from ICG Utilities (Ontario) Ltd's non-utility investments as defined by the Ontario Energy Board, including, but not limited to, the Cogeneration project.

2. The Board recommends that the Lieutenant Governor in Council grant ICG Utilities (Ontario) Ltd the requested exemption to Article 3.0 of the 1988 Undertakings in respect of the gas supply contract for the cogeneration project with ICG Resources Inc.

3. The Board recommends that the Government clarify its policy on the role of gas utility companies in developing non-utility electric generation projects in Ontario. In so doing, the existing undertakings given to the Lieutenant Governor in Council by these Companies should be reviewed.

4. The Board recommends that, in the absence of legal separation of the project from the utility operations of ICG Utilities (Ontario) Ltd, as recommended by the Board in its Recommendation 2(b), the Lieutenant Governor in Council, pursuant to the provisions of Section 19 of the Act, deny ICG's request for special accounting treatment and direct ICG Utilities (Ontario) Ltd to continue to operate under the jurisdiction of the Ontario Energy Board with respect to the amounts to be excluded from utility rate base, utility income, and taxes applicable on account of the cogeneration project.

5. The Board recommends that the Lieutenant Governor in Council deny ICG Utilities (Ontario) Ltd's request for a regulation separating the assets and income of the

cogeneration project from those of the regulated utility for the purposes of Section 19 of the Ontario Energy Board Act.

# 1. THE HEARING

## 1.1 THE REFERENCE

1.1.1 On April 10, 1989, ICG Utilities (Ontario) Ltd ("ICG Ontario" or "ICG") applied to the Ontario Energy Board ("the Board"), for exemptions to undertakings given to the Lieutenant Governor in Council in June, 1988 by ICG and its corporate shareholders ("the 1988 Undertakings" or "the Undertakings") and for certain orders related to a proposed investment by ICG Ontario in a cogeneration project to be built at the pulp and paper mill of Boise Cascade Canada Ltd. ("Boise" or "Boise Canada") in Fort Frances, Ontario. The project is proposed to be owned by ICG Ontario and held as a Division of the utility company. This Application was given Board File Number E.B.O. 161. ICG

subsequently sought to proceed by means of a Reference to the Board from the Lieutenant Governor in Council.

1.1.2 On June 12, 1989, the Lieutenant Governor in Council signed an Order in Council, which, pursuant to section 36 of the Ontario Energy Board Act ("the Act"), required that the Board examine and, after holding a public hearing with respect to the cogeneration project, report to the Lieutenant Governor in Council on the following matters:

a. whether ICG should be exempted from compliance with Article 5.4 of the 1988 Undertakings in respect of the Cogeneration Project;

b. whether the purchase of gas by ICG from ICG Resources should be approved pursuant to Article 3.0 of the 1988 Undertakings.

1.1.3 Articles 5.4(a) and (b) of the Undertakings bar ICG or a person which it controls from investing in a non-utility (non-regulated) activity and provide that ICG will attempt to restructure itself, such that it will be a corporation whose assets, liabilities and activities relate only to the regulated natural gas distribution business in Ontario. Article 3.0 requires approval of transactions between ICG and its affiliate companies amounting to more than $100,000 annually.

1.1.4 The proposed cogeneration project is a significant non-utility investment resulting in increased diversification of ICG Ontario and hence requires exemption from the Undertakings. ICG Resources Ltd ("ICGR") an affiliate company at the time of the Application, is a principal supplier of gas to the project, thus requiring ICG to seek dispensation under Article 3.0.

1.1.5 The Order in Council also noted that ICG had requested that the Lieutenant Governor in Council require the Board to examine and report on whether a regulation should be made separating, for ratemaking purposes under Section 19 of the Act, ICG's investment in the cogeneration project and the resulting income tax deferrals from ICG's regulated gas distribution activities. Accordingly, the Board was also asked to examine and, after holding a public hearing report on whether:

c.

(i) in the determination of the rate base of ICG for the purposes of section 19 of the Act, the Cogeneration Project and all property which is used or useful in the construction or operation of the Cogeneration Project should be excluded;

(ii) in the determination of the income of the utility operations of ICG for the purposes of section 19 of the Act, all revenues and expenses which are attributable to the Cogeneration Project should be excluded;

(iii) for the purposes of section 19 of the Act, any tax savings or tax deferrals which are realized by ICG and which are attributable to the tax treatment under the Income Tax Act (Canada) of the Cogeneration Project, including, without limiting the generality of the foregoing, any capital cost allowances claimed by ICG under the Income Tax Act (Canada) in respect of the Cogeneration Project, should not be applied by the Board:

- to reduce the amount otherwise determined, for the purpose of section 19 of the Act, to be income taxes in respect of the utility operations of ICG, or

- to reduce the rates and other charges that would otherwise be payable by customers of ICG for the sale, transportation and storage of gas.

## 1.2 THE ROLE OF THE BOARD

1.2.1 The 1988 Undertakings were given to the Lieutenant Governor in Council by ICG and its controlling shareholders, ICG Utilities Canada Ltd. ("ICG Canada") and Inter-City Gas Corporation ("Inter-City"). They represent

an extension of Section 26 of the Act and also the conditions which, the parties agree, constitute the necessary safeguards to ensure that the regulated utility and its ratepayers will not be adversely affected by certain business activities of the shareholders which involve or may affect the utility operating company.

1.2.2 The Board sees its role as analogous to performing, usually by means of a public hearing, "due diligence" on behalf of the ratepayers of ICG and the public of Ontario, in respect of any matters which affect the interests of these parties and which are encompassed by the 1988 Undertakings and the Act.

1.2.3 The Board also maintains routine contact with Ontario's three major gas utilities on matters related to their undertakings. The Board advises the parties to these undertakings on their effective administration.

## 1.3 THE HEARING

1.3.1 On June 28, 1989, the Board issued three Notices of Hearing under Board File No. E.B.R.L.G. 33, which indicated the nature of

the reference, notified intervenors of the date for the hearing and of the applicability of the Intervenor Funding Project Act ("IFPA").

1.3.2 On July 20, 1989, the Board issued Procedural Order No. 1 which confirmed August 23, 1989 as the date for the commencement of the hearing, gave instructions for the filing of interrogatories related to ICG's prefiled evidence and set out a preliminary issues list.

1.3.3 On August 17, 1989, following receipt of an application for funding from the Association of Municipalities of Ontario ("AMO"), a hearing was held before Board Member C.A. Wolf Jr. under the provisions of the IFPA. On August 18, 1989, Counsel to AMO withdrew the funding application. No other applications for intervenor funding were filed.

1.3.4 On August 23, 1989, the hearing convened to consider procedural matters, to review the status of interrogatories and to finalize an issues list. This having been accomplished, the hearing was adjourned until September 6, 1989, the first day of ICG's evidence. The issues list and order of witness panels was published in the Board's Procedural Order No. 2 dated August 29, 1989.

1.3.5 The hearing commenced on September 6, 1989 and concluded with the submission of argument from all parties on October 31, 1989.

**Appearances**

1.3.6 The following is a list of participants and their representatives:

| | |
|---|---|
| Counsel to Board Staff | J. Campion |
| ICG | J. Roland, Q.C.<br>A. Dadson |
| AMO | G. Kaiser |
| The Consumers' Gas Company Ltd. ("Consumers Gas") | P. Atkinson<br>F. Cass |
| Ontario Hydro ("Hydro") | J. Prior |
| Boise | D. Gibson<br>J. Hollerman |
| Union Gas Limited ("Union") | D. Sulman |
| North Shore Industries ("NSI") | R. Wilson |
| TransCanada PipeLines Limited ("TCPL") | J. Schatz |

| | |
|---|---|
| ATCOR Ltd | R. Rhodes |
| Northland Power ("Northland") | J. Brace |
| Independent Power Producers Society of Ontario ("IPPSO") | N. Teekman<br>J. Shepherd |
| Indeck Energy Services Inc. ("Indeck") | T. Brett |
| Industrial Gas Users Association ("IGUA") | P. Thompson, Q.C.<br>B. Carroll<br>G. Pratte |

**Witnesses**

1.3.7 The following witnesses were called:

For ICG Utilities (Ontario) Ltd:

| | |
|---|---|
| N.J. Didur | President & Chief Executive Officer, ICG Utilities (Ontario) Ltd |
| E.P. Rimmer | Vice President Cogeneration Division, ICG |
| M.G. Meacher | Project Director, ICG/Boise Cascade Cogeneration Project |
| E.C. Valiquette | Vice President, Finance & Administration, ICG |
| P.D. Pastirik | Manager of Financial Planning, ICG |
| P. Marriott | Chief Financial Officer, Inter-City |

| | |
|---|---|
| W.M. Bingham | Manager, Regulatory Proceedings, ICG |
| P.J. Hoey | Supervisor, Rate Design and Cost of Service Studies, ICG |
| D. Forster | Partner and Tax Specialist, Coopers & Lybrand Ltd. |
| R.D. Falconer | Vice President & Director, Wood Gundy Inc. |

For Boise Canada:

| | |
|---|---|
| J. Valley | Vice President, Corporate and Board Affairs, Boise |

For Indeck Energy Services Inc:

| | |
|---|---|
| M. Polsky | President, Indeck Energy Services Inc. |

For Northland Power:

| | |
|---|---|
| A.F. Anderson | Vice President, Finance and Administration, Northland |

1.3.8 The Application dated April 10, 1989, under Board File No. E.B.O. 161, has not been withdrawn and the file remains open. This may expedite matters in regard to Board Orders related to the cogeneration project should the Lieutenant Governor in Council, having received this Report, direct ICG to apply for such Orders.

1.3.9 In making its Report, the Board has carefully evaluated all the evidence and submissions

before it, but has summarized these in this Report only to the degree necessary to provide an understanding of specific issues addressed by the Board.

1.3.10 A verbatim transcript of the proceedings, together with a copy of all exhibits, is retained in the Board's files and is available for public review.

# 2. BACKGROUND

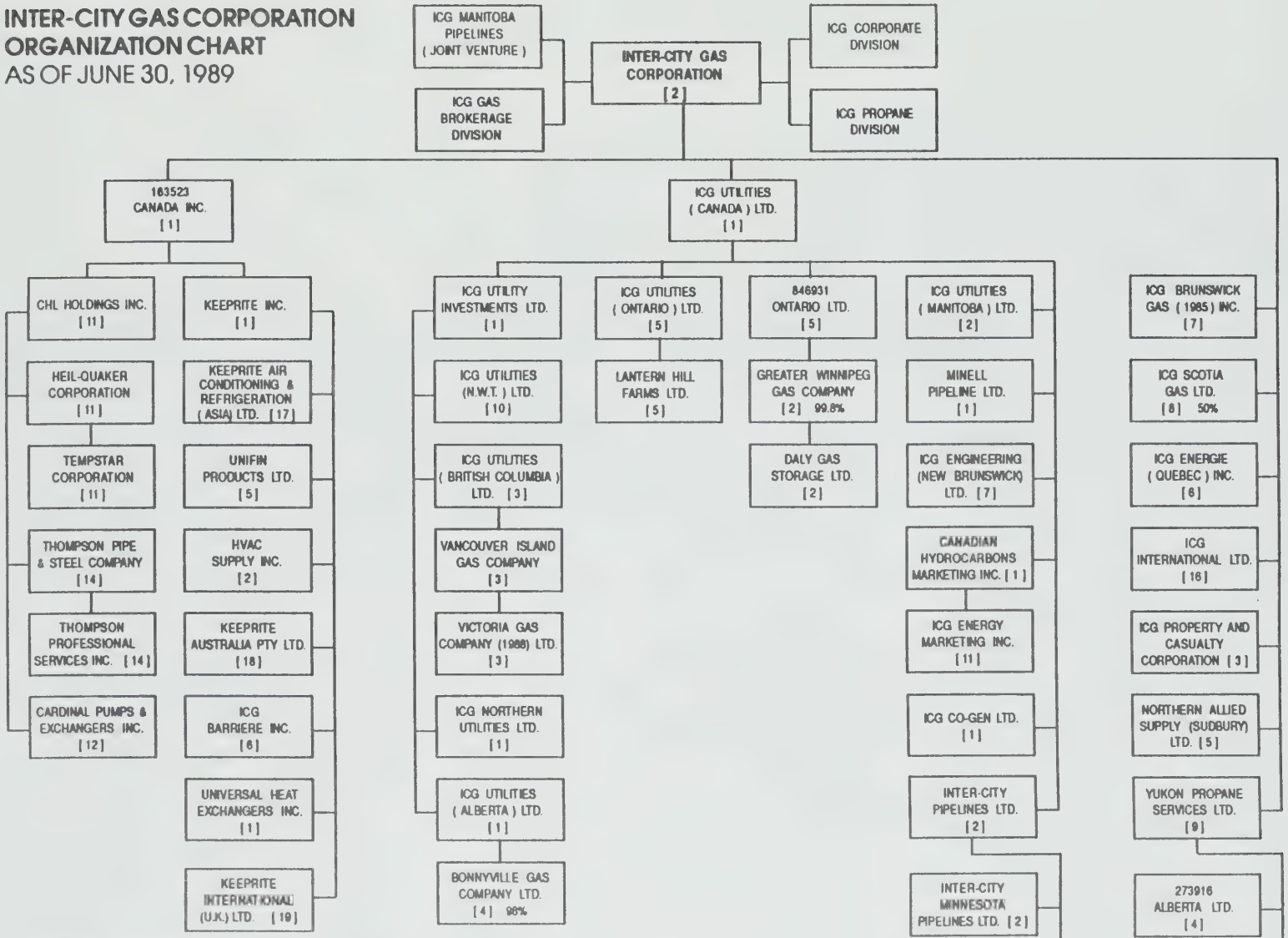
## 2.1 ICG UTILITIES (ONTARIO) LTD

2.1.1 ICG is a wholly-owned subsidiary of ICG Canada which, in turn, is wholly-owned by Inter-City.

2.1.2 The Inter-City organization chart, at the time of the hearing, is shown in Figure 1. ICG Canada, it will be noted, also owns ICG Transmission Ltd. and ICG Transmission Holdings Ltd. which together operate a gas transmission system in northwestern Ontario. This system supplies, among other locations, the Fort Frances area.

2.1.3 On July 4, 1989, Inter-City and Westcoast Energy Inc. ("Westcoast") signed a letter of agreement which provides for the acquisition by Westcoast, or by a wholly-owned subsidiary of Westcoast, of the utility businesses owned

# INTER-CITY GAS CORPORATION ORGANIZATION CHART
AS OF JUNE 30, 1989




**JURISDICTIONS OF INCORPORATIONS**

1. Canada
2. Manitoba
3. British Columbia
4. Alberta
5. Ontario
6. Quebec
7. New Brunswick
8. Nova Scotia
9. Yukon Territory
10. Northwest Territories
11. Delaware, U.S.A.
12. Ohio, U.S.A
13. Texas, U.S.A.
14. Colorado, U.S.A.
15. Tennessee, U.S.A.
16. The Bahamas
17. Hong Kong
18. New South Wales, Australia
19. United Kingdom

All subsidiaries are 100% owned unless otherwise indicated.



Figure 1

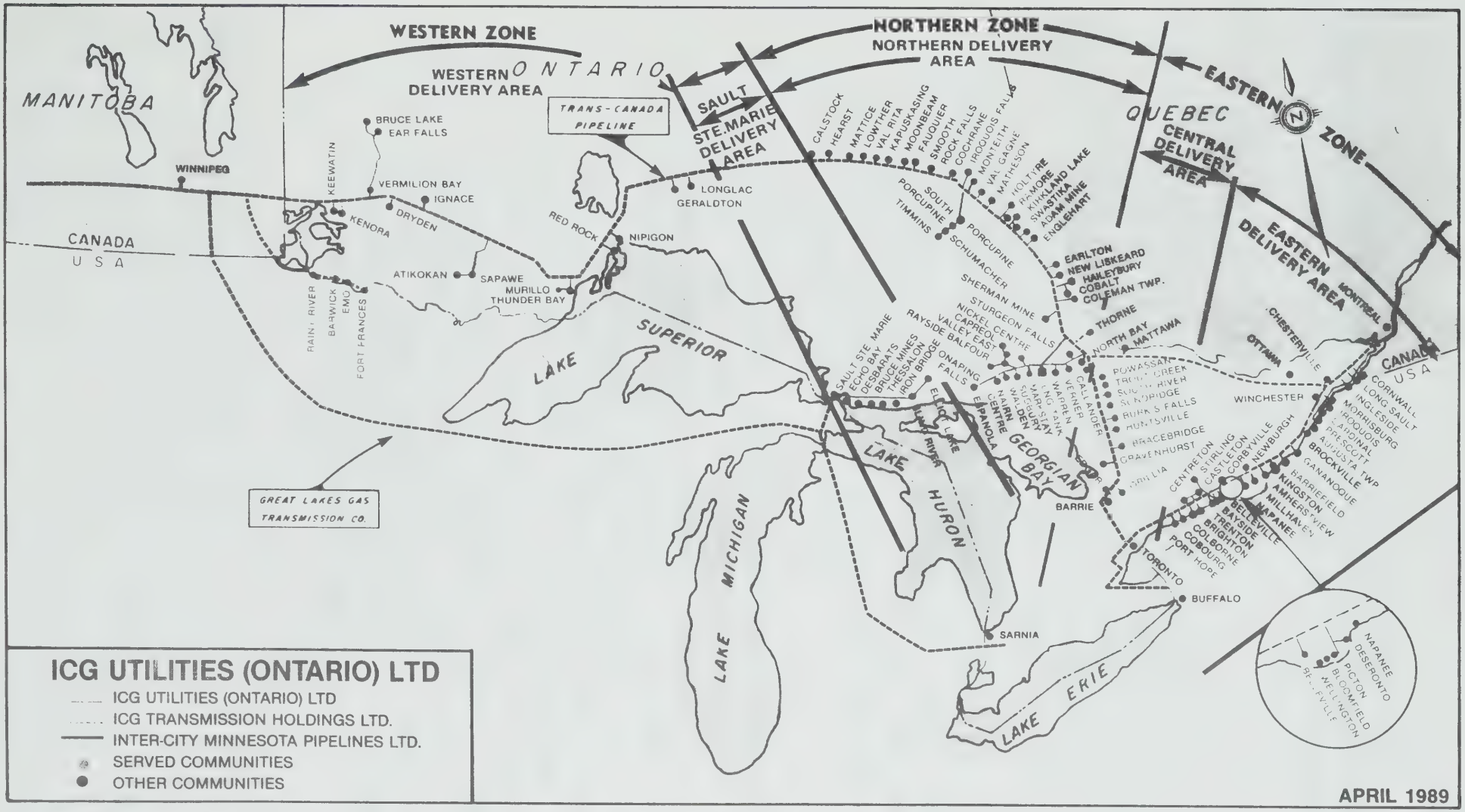
directly or indirectly by Inter-City, including ICG Ontario. At the same time, ICGR, a gas exploration and development company, was sold to the Saskatchewan Oil and Gas Corporation, and other oil and gas interests to Shell Canada Ltd.

2.1.4 ICG Ontario is the company which contains the regulated gas distribution company ("the utility") which holds franchises in northern Ontario and several southern and eastern areas of Ontario. A map of the Distribution System of ICG Ontario is shown in Figure 2.

2.1.5 The utility operations of ICG Ontario serve 150,000 customers in over 100 cities, towns, townships and villages, with gas transmitted from western Canada by TCPL. ICG purchases gas directly for its utility operations from a number of suppliers of which the largest is Western Gas Marketing Limited ("WGML"), a wholly-owned subsidiary of TCPL.

2.1.6 The service area of ICG Transmission Holdings Ltd. is not yet fully integrated into the utility's system and rates. Some special rates also exist, including a rate for the Boise mill in Fort Frances, which is the sole large industrial customer of ICG's Fort Frances System.

# DISTRIBUTION NETWORK




ICG UTILITIES

**Energy Working For You**

Figure 2

2.1.7 ICG Ontario, as of December 31, 1988, had assets with a total book value of $740 million. The average utility rate base for 1988 is $399 million as determined by the Board in its Decision in the utility's last rate case in E.B.R.O. 440, dated February 19, 1988. ICG Ontario's 1988 net income, after tax, was reported as $36.5 million of which $22.3 million was estimated by ICG to be associated with utility operations and the balance with non-utility investments.

2.1.8 Since December 1988, ICG Ontario, in accordance with the intent of Article 5.4(b) of the Undertakings, has undergone a reorganization of its non-utility investments. Its holdings in Greater Winnipeg Gas Company ("GWG") have been transferred to ICG Canada. This has changed the Balance Sheet and Income projections for 1989, and also resulted in the transfer and cancellation of 3,577,254 common shares effective June 30, 1989. ICG's non-utility assets, at the time of the hearing, were about $100 million, mostly in the form of investments in securities and a loan to Inter-City.

## 2.2 UNDERTAKINGS AND SECTION 26 OF THE ACT

2.2.1 Section 26(2) of the Act requires that:

> no person, without first obtaining the leave of the Lieutenant Governor in Council, shall acquire such number of any class of shares of a gas transmitter, gas distributor or storage company that together with shares already held by such person or by such person and an associate or associates of such person will in the aggregate exceed 20 percent of the shares outstanding of that class of the gas transmitter, gas distributor or storage company.

2.2.2 During 1985 and 1986, the Government of Ontario was concerned about protecting the public interest during takeovers of Union and Consumers Gas, the province's two largest gas utilities.

2.2.3 In its E.B.R.L.G. 28 Report dated August 2, 1985, regarding the Unicorp acquisition of Union, the Board recommended amendments to undertakings given to the Lieutenant Governor in Council by Unicorp on January 1, 1985.

2.2.4 In its Report to the Lieutenant Governor in Council dated November 26, 1986 (Board File No. E.B.L.R.G. 30)regarding the takeover of Consumers Gas, the Board recommended that, in consideration for granting approval of the

corporate reorganization, certain undertakings should be given. On December 12, 1986 such undertakings were executed and, once the corporate restructuring was complete, the undertakings were re-executed on March 4, 1987.

2.2.5 On October 22, 1986, the then Minister of Energy, the Honourable Vincent G. Kerrio, introduced into the Legislature Bill 142, An Act to Amend the Ontario Energy Board Act.

2.2.6 In his speech to the Legislature Mr. Kerrio indicated that:

> the new legislation would introduce "rules of conduct" designed to further ensure that the public interest in natural gas price, service and reliability is protected. Using this "picket fence" approach assures protection of the public interest -- regardless of who owns or controls the utility.

2.2.7 Specifically with respect to diversification, Mr. Kerrio noted that:

> Diversification is an ordinary and necessary aspect of private sector business. Our natural gas distribution system in Ontario is mature, and our utilities will require smaller amounts of capital for system expansion. So it is natural for these companies to seek opportunities to diversify.

> However, the Government must ensure that customers and the utilities themselves are not exposed to unnecessary and undesirable risks - particularly when the companies are investing their earnings in peripheral or non-utility businesses.

2.2.8 In noting the features of the proposed legislation, Mr. Kerrio stated in part:

> These amendments will "insulate" gas utilities from the risks associated with non-utility activities. The amendments will:
>
> - Require non-utility investments as of April 9, 1986, and later, to be carried out in separate, non-subsidiary corporations;
> - Forbid a utility to advance funds to or guarantee the obligations of an affiliate.
>
> Exemptions from the application of these provisions will be available only with the approval of the Ontario Energy Board. No other exemptions are provided for.

2.2.9 Bill 142 would have superseded the undertakings by amending the Act and by providing direct authority to the Board, but it did not proceed past second reading.

**ICG's 1988 Undertakings**

2.2.10 The Fort Frances System was formerly owned by Inter-City. The transfer of the Fort Frances

System by Inter-City to ICG Ontario was completed on August 31, 1988, pursuant to the leave granted by the Lieutenant Governor in Council under Order-in-Council 1825/88 dated July 28, 1988.

2.2.11 In consideration of the Lieutenant Governor in Council:

a) granting leave pursuant to section 26 of the Act, to permit ICG Ontario to acquire the Fort Frances System from Inter-City; and

b) exempting ICG Canada from the provisions of Section 26, with respect to the acquisition by ICG Canada from Inter-City of 48 percent of the common shares of ICG Ontario,

ICG Ontario, together with Inter-City and ICG Canada, executed the 1988 Undertakings.

2.2.12 Article 3.0 of the Undertakings provides as follows:

**Affiliated Transactions:**

> Other than the sale and the transportation of gas by ICG Ontario, any affiliated transaction aggregating $100,000 or more annually shall require prior approval of the Ontario Energy Board, which approval shall not be withheld if the transaction is shown to be of benefit to ICG Ontario or takes place at or below fair market value.
>
> It shall not constitute a violation of this undertaking if ICG Ontario or the associate or affiliate did not know, or could not have been reasonably expected to know, that a transaction was an affiliated transaction.

2.2.13 Article 5.4 of the 1988 Undertakings provides as follows:

**Diversification and Reorganization:**

> (a) ICG Ontario itself, or through a person it controls, shall not hereafter engage or invest in any activity that is not subject to the regulation of the Ontario Energy Board.
>
> (b) Inter-City, ICG Canada and ICG Ontario shall make reasonable efforts to accomplish a restructuring of ICG Ontario such that there will result a corporation whose assets, liabilities and activities

relate only to the regulated natural gas distribution business in Ontario.

(c) A signatory may, from time to time, apply to the Ontario Energy Board for dispensation from compliance with sub-paragraphs (a) and (b) hereof.

## 2.3 COGENERATION AND THE ICG/BOISE CASCADE PROJECT

2.3.1 Cogeneration is the simultaneous co-production of electricity and heat, the latter in the form of steam or hot gas, from the combustion of fossil fuels such as coal, oil, gas, wood waste, or from a waste heat source. The efficiency of most types of cogeneration is higher than for the production of either the electricity or heat product alone.

2.3.2 Cogeneration is most frequently an attractive technology for industrial sites which require both electrical power and heat energy. In addition, there may be the capacity to generate more electrical power than the on-site requirements of the industry. This power can be sold to an electrical utility to either reduce the fuel used by the electrical utility or to reduce its installed generation capacity if, in the latter case, firm electrical capacity can be provided by the cogeneration plant.

2.3.3 Cogeneration, therefore, results in increased efficiency in the use of fuel resources, thus reducing industrial energy costs and also the environmental impacts of fossil fuel burning. For some industries, energy costs are a significant component of production costs. Cogeneration also reduces the amount of power that the local electric utility has to supply to industries with cogeneration plants. These plants often provide excess electrical power at competitive prices which the electrical utility can purchase for resale, thereby reducing the amount of power it needs to generate itself to meet customer power demand.

2.3.4 In Ontario, the provincial government has been strongly supportive of independent power production by the private sector. This support includes cogeneration, which provides load reduction benefits to Hydro, and parallel generation, which provides capacity and energy to Hydro for resale to its direct industrial and rural customers and to the local municipal electric utilities.

2.3.5 As a result of government policy, financial support and the institution of new purchase policies and rates by Ontario Hydro in 1986, 25.4 MW of Hydro peak capacity was provided by independent private power generators, as of the

end of 1988. This represented just over one percent of the utility's peak demand in that year.

2.3.6 As part of its plans to achieve its recent target of 2000 MW for purchased private power, Hydro has established a Non-Utility Generation Division and instituted new purchase rates (buy-back rates). It has also attempted to streamline the review and approval process for private generators and is also providing financial assistance to some projects, including the ICG/Boise project, on a 'demonstration basis'.

2.3.7 In July 1989, the Government of Ontario released a Ministry of Energy policy paper which reiterated its continuing support of non-utility generation. The paper suggested that a potential of more than 2000 MW of economical non-utility generation could be available and also endorsed the ICG/Boise Fort Frances project as providing almost 100 MW of this capacity.

2.3.8 As recently as October 31, 1989 a senior official in the Ministry of Energy, in a speech to the Ontario Hydro Non-Utility Generation Workshop, commented on the sod-turning ceremony in Fort Frances earlier in 1989, at which the

Premier and the Chairman of Ontario Hydro had been present, and then stated that:

> "Who wouldn't be enthusiastic about the Fort Frances project? The $100 million cogeneration facility is the largest new cogeneration plant in Ontario. It will be the first of its kind for the pulp and paper industry in the province. When it's completed the plant will generate 94 megawatts of electricity to be sold to Ontario Hydro. The steam energy will be used by Boise Cascade in its paper production.
>
> What's more the project is environmentally sound. The cogeneration facility will not only surpass current air quality standards but will meet more stringent standards than have been proposed under the Clean Air Program. As a result of the higher efficiency achieved through cogeneration the overall environmental impact is low."

**ICG/Boise Cascade Cogeneration Project**

2.3.9 According to ICG and Boise Canada, the genesis of the ICG/Boise Cascade Fort Frances cogeneration project arose between Boise Cascade and Hydro in 1985/86. On the one hand, Boise wished to improve the reliability and cost of the major energy inputs to its Fort Frances mill and also recognized the future need to replace its existing steam production plant. On the

other hand, Hydro was attracted by the potential for a significant source of local electrical capacity in the Fort Frances area which could improve the reliability of local power supply and also provide tangible evidence of its new commitment to non-utility generation.

2.3.10 According to Boise, it was determined, after feasibility studies, that although a viable project appeared possible, it was not attractive to Boise for its own investment, since such a discretionary project had to compete with more essential capital investment needs. Accordingly, the project would have to provide a higher return on investment than these investments.

2.3.11 Boise and Hydro were approached by several companies and consortia interested in the project and narrowed these to TCPL and ICG. After further review and negotiation, ICG was selected to finance and own the cogeneration plant which was to be built on leased lands adjacent to Boise's Fort Frances mill.

2.3.12 ICG has signed contracts dated January 3, 1989 with Ontario Hydro and Boise Canada with respect to:

a) the construction and operation of the cogeneration project on the premises of

Boise Canada in the Town of Fort Frances, Ontario; and

b) the sale of the steam and electric power generated by the cogeneration project to Boise Canada and Ontario Hydro respectively.

2.3.13 The cogeneration project, as finally designed, includes a 59 MW gas turbine driven generator, a heat recovery steam generator, an auxiliary high pressure boiler and a 46 MW condensing steam turbine driven generator equipped with steam extractors. A schematic plan of the project is shown in Figure 3.

2.3.14 The facility will be enclosed in a building to be constructed on Boise Canada's property. Boise Canada will manage, operate and maintain the cogeneration project on behalf of ICG Ontario under the terms of a management agreement ("the Management Agreement") between Boise Canada and ICG Ontario. The Management Agreement, which has an initial term of 15 years, gives Boise Canada the option to purchase the facility at a nominal cost at the end of that term.

# ICG COMBINED CYCLE COGENERATION
# ELECTRICAL/STEAM PRODUCTION
# Overall Efficiency = 75%

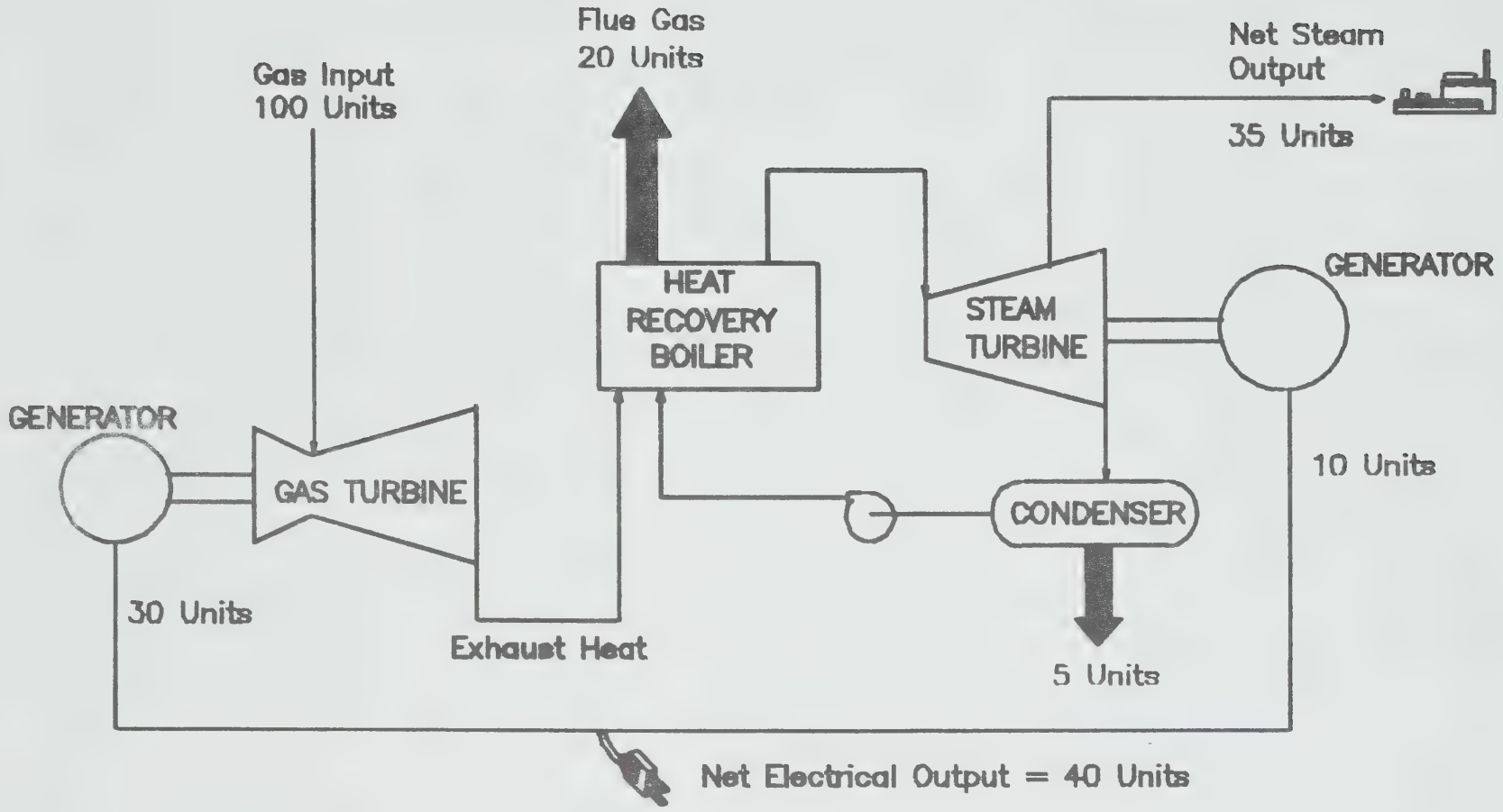



Figure 3

2.3.15 The cogeneration project will use about 7 Bcf of natural gas on an annual basis. That gas will be used to fuel the gas turbine, to heat the building enclosing the facility, and to fire the heat recovery steam generator and the auxiliary boiler.

2.3.16 The cogeneration project will be supplied with gas purchased under long-term gas supply contracts with ICGR and North Canadian Marketing Inc, ("North Canadian"). The price of the gas under those contracts will be indexed to increases in the rates charged by Ontario Hydro for the sale of power to Ontario Hydro's large industrial customers.

2.3.17 The electric power generated by the cogeneration project will be transformed to 115 KV and sold to Hydro. ICG estimates that annual sales of electric power to Hydro from the facility will total $660 \times 10^3$ MWh.

2.3.18 The sale of electric power to Ontario Hydro will be governed by the terms of an electric power purchase agreement ("the Power Purchase Agreement") between Hydro and ICG Ontario. Under the Power Purchase Agreement, Hydro will be obligated to purchase all the electrical power generated by the cogeneration project, up to a specified maximum, and to pay base rates

equal to the rates charged by Hydro to its direct industrial customers for firm service on Ontario Hydro's 115 KV power system. The Power Purchase Agreement will contain provisions protecting ICG Ontario in the event that Boise Canada's mill is closed on a permanent basis after the end of the seventh contract year.

2.3.19 ICG Ontario estimates that the capital costs of the cogeneration project will total almost $100 million. ICG Ontario proposes that the cogeneration project be financed by:

a) a loan of $45 million from Hydro;
b) an equity investment of approximately $18 million by Inter-City; and
c) funds available from income tax deferrals in an amount of approximately $35 million.

2.3.20 Hydro will lend ICG Ontario approximately 45 percent of the capital costs of the cogeneration project. The Hydro Loan Agreement will provide for an interest rate of 4 percent and the repayment of principal over a period of 10 years. That repayment period will commence 5 years after the date on which the cogeneration project commences operation.

2.3.21 At the time of the Application, approximately $12 million had been spent after construction

commenced in late 1988. By the close of the hearing, ICG indicated that about $25 million had been spent and its evidence projected that a total of $58 million would be expended by the end of 1989 with the remaining $40 million to be spent in 1990.

## 3. REQUEST FOR EXEMPTIONS TO ARTICLES 5.4 AND 3.0 OF ICG'S 1988 UNDERTAKINGS

### 3.1 INTRODUCTION

3.1.1 The reference letter asked the Board to report to the Lieutenant Governor in Council whether ICG Ontario should be granted an exemption to Article 5.4 of the Undertakings in order to allow it to invest in the cogeneration project as a non-utility (non-regulated) investment, and whether the purchase of gas by ICG from ICGR should be approved pursuant to article 3.0 of the Undertakings.

3.1.2 The issue of an exemption to Article 3.0 of the Undertakings is technically still before the Board despite the sale of ICGR to the Saskatchewan Oil and Gas Corporation in mid-1989. At the time of the execution of the gas contract, it was an affiliate transaction falling under Article 3.0. In addition, the

reference specifically asks for this matter to be addressed by the Board in its report.

3.1.3 In considering whether to recommend if an exemption to Articles 5.4(a) and (b) of the Undertakings should be granted, the Board considered the following matters:

- o Government Policy
- o Structure of the Investment
- o Project Economics and Viability
- o Shareholder Considerations
- o Risks and Benefits to the Utility Ratepayers

This chapter contains only a summary of ICG's evidence and the Board's findings, in the interests of conciseness and readability. It must be borne in mind, however, that there were many opinions on the issues expressed by the other parties to the hearing and these are summarized in Appendix A hereto.

## 3.2 POLICY CONSIDERATIONS

3.2.1 There are two main areas of government policy which bear on the request by ICG to the Lieutenant Governor in Council and the Reference to the Board. These are the province's policy on cogeneration, and its

position on non-utility investment and diversification by regulated gas utilities in Ontario.

3.2.2 As noted in Chapter 1 there is a historical background to, and previous evidence of government policy statements on, both these areas.

**Cogeneration Policy**

3.2.3 ICG noted the provincial government's encouragement and support of parallel generation, including cogeneration, and the fact that the Board in its E.B.R.O. 430 Decision had pointed out the potential for cogeneration in ICG's service area and required ICG to update the Board on its efforts to penetrate this market.

3.2.4 The latest official government position on cogeneration is contained in a policy statement and background paper released by the Honourable Robert Wong, then Minister of Energy, on July 20, 1989. This noted the benefits of parallel generation and requested Hydro to meet its 1000 MW target by 1995 and to achieve 2000 MW by the year 2000.

3.2.5 In reviewing the potential for parallel generation in Ontario, the background paper noted that:

> "The Ontario pulp and paper industry is facing significant investment pressures .... Changes in the marketplace have necessitated investments in new technology to improve the quality of paper.
>
> These investments will provide a significant opportunity to encourage investments in cogeneration. As a result, the sector should be targeted aggressively as Ontario Hydro has done, particularly in the Northwest where most of the large pulp and paper plants are located. New investments at the Boise Cascade plant in Fort Frances will create 90 MW of cogeneration capacity."

3.2.6 With respect to the use of natural gas as fuel for parallel generation the paper noted:

> As a non-renewable resource it can be expected that natural gas will increase in price in future, perhaps substantially. At a certain price level, gas would no longer be an attractive fuel for electricity generation. However, the Ministry envisages natural gas to be a transition option which could be an economic generation fuel for perhaps the next twenty years. ..... the Ministry believes that the risk of gas price increases can be limited by appropriate contract terms including exit provisions.

3.2.7 The background paper was silent on the role of gas utilities as developers of non-utility generation projects in Ontario. However, it noted the proposal by Consumers Gas and TCPL to build up to 1000 MW of gas fired generation at the R.L. Hearn Generating Station in Toronto.

**Utility Diversification and Section 26 of the Act**

3.2.8 As noted in Chapter 2, although there have been no public statements recently, the government has, in the past, made policy pronouncements about diversification by the province's regulated gas utilities into non-utility businesses. These statements, the existing undertakings signed by each of the utilities and their corporate shareholders, and the Board's own decisions, are aimed at ensuring that non-utility investments do not pose any risk to gas utility ratepayers in Ontario and, in the case of ICG, also at moving towards a pure utility company structure.

3.2.9 Articles 5.4(a) and (b) of the 1988 Undertakings require that ICG, or its corporate shareholders through ICG, refrain from investing in non-utility businesses (subject to any exemption as provided in Article 5.4(c)), and also make reasonable efforts "to accomplish a restructuring of ICG Ontario such that there will result

a corporation whose assets, liabilities and activities relate only to the regulated natural gas distribution business in Ontario".

3.2.10 ICG stated in evidence that, at the time it was negotiating the Undertakings in 1988, it and other parties to the negotiations were aware of the proposal for ICG to participate in the Boise Cascade Fort Frances cogeneration project.

3.2.11 ICG claimed that it was for this reason that the ability to obtain dispensation from compliance with the Undertakings was provided in Article 5.4(c).

3.2.12 ICG noted that it had originally planned to obtain leave from the Lieutenant Governor in Council before any substantial financial commitment was made to the cogeneration project, but this had not proved possible. It also noted that its original concept was for the project to be in ICG Ontario for only a few years and to move it outside the utility company after some period, but for tax and economic reasons this was neither feasible nor attractive.

3.2.13 Several of the parties to the hearing wished to examine the issue of whether ICG, by virtue of

its being a regulated gas utility, was in a position to exercise unfair financial and market competitive advantages which other private power developers could not realize. The Board declined to hear evidence on this matter since it was not included, either directly or indirectly, in the terms of the Reference to the Board from the Lieutenant Governor in Council.

## 3.3 STRUCTURE OF THE PROJECT INVESTMENT

3.3.1 ICG Ontario stated that it had considerable interest in cogeneration because of the potential it provides to increase gas use and, consequently, to increase the throughput on its system. It stated that it was prepared to promote cogeneration and to assume a leading role in cogeneration projects in order to generate increased gas use in its franchise area.

3.3.2 ICG Ontario indicated that it had held discussions with some of its major industrial customers, as well as Boise Canada, and these discussions showed that further cogeneration projects, perhaps five or six in number, were possible.

3.3.3 Primarily for income tax reasons, ICG proposed that the Fort Frances cogeneration project be owned by ICG and be held as another operating division of the utility company, rather than in a separate legal entity. It also stated that it would attempt to negotiate follow-on projects so that these could be structured on a stand alone basis. However, some future projects may be undertaken in a similar manner to that proposed for the ICG/Boise Fort Frances project, in order to generate other tax deferrals by claiming accelerated capital cost allowances on cogeneration plant assets against utility income.

3.3.4 ICG has established a Cogeneration Division to manage and perform all services required by the cogeneration project. ICG Ontario will provide certain services to this Cogeneration Division which, however, will pay for all services contracted for on its behalf by ICG Ontario.

3.3.5 ICG proposed that its Utility Division will provide the following services for which the Cogeneration Division will be charged:

a) gas transportation;
b) accounting services;
c) information systems; and
d) accommodation and office equipment.

3.3.6 The legal obligations of ICG's Cogeneration Division are proposed to be assumed by ICG Ontario which, in terms of assets, income and staff is at present essentially the regulated gas utility.

3.3.7 The proposed Cogeneration Division will be staffed by a combination of reassigned utility personnel and staff hired directly for the Cogeneration Project.

**Capital Financing**

3.3.8 ICG'S proposed capital structure will take maximum advantage of the tax deferrals available from the project's Class 34 assets:

| Capital | Source | | $ million |
|---|---|---|---|
| Debt | Hydro loan | 45 | (or 45% of total cost) |
| Equity | Inter-City | 20 | (or 20% of total cost) |
| Deferred Taxes | ICG Ontario | 35 | (or 35% of total cost) |
| Total | | 100 | |

3.3.9 In order to realize the deferred taxes, ICG Ontario wishes to offset the accelerated capital cost allowances on the cost of the cogeneration plant's Class 34 assets, against

its consolidated net income before income taxes during the years 1989 to 1991. Since the transfer of the GWG assets to ICG Canada, this income is almost exclusively derived from the operations of the regulated utility. These income tax benefits are proposed to be "streamed" to the Cogeneration Division to finance the Fort Frances project and will be repaid in future years from ICG Ontario's consolidated taxable income.

**Contractual Arrangements**

3.3.10 In all, 15 contracts have been executed by ICG Ontario, which is, therefore, legally obligated on behalf of the Cogeneration Division for its performance under these contracts, (Table 1 on the next page).

3.3.11 Complete copies of the contracts, including those for gas supply, were not provided as evidentiary material during the hearing due to the claimed confidential nature of certain clauses. However, pursuant to section 62 of the Act, copies were filed with the Board's Energy Returns Officer ("ERO") and summaries were filed as evidence in the hearing.

Table 1.

ICG Contracts Related to Cogeneration Project

| | CONTRACT | PARTIES |
|---|---|---|
| 1. | Gas Supply Contract | ICGR |
| 2. | Gas Supply Contract | North Canadian |
| 3. | Transportation Contract | TCPL |
| 4. | Transportation Contract | ICG Transmission Holdings Ltd. |
| 5. | Transportation Contract | Inter-City Minnesota Pipelines Ltd., Inc. |
| 6. | Energy Sales Agreement | Boise |
| 7. | Management Agreement | Boise |
| 8. | Lease Agreement | Boise |
| 9. | Access, Piping and Construction Easement | Boise |
| 10. | Makeup Water Agreement | Boise |
| 11. | Termination Agreement | Boise |
| 12. | Default Agreement | Boise<br>Hydro |
| 13. | Power Purchase Agreement | Hydro |
| 14. | Loan Agreement | Hydro |
| 15. | Design-Build and Construction Management Agreement | Fluor Daniel Canada, Inc. |

**Income Tax Considerations**

3.3.12 Through its tax consultants Coopers & Lybrand, ICG sought a ruling from Revenue Canada that it was eligible to claim the capital cost allowance ("CCA") from the cogeneration project. The ruling was sought since the project was to be located on leased land and also because there were provisions in the contracts for a sale of the assets to Boise or Hydro. In addition, ICG sought a ruling from Energy Mines and Resources Canada ("EMR") that the project's assets would qualify under Class 34 for depreciation purposes.

3.3.13 ICG claimed that the details of Revenue Canada's tax ruling for the project were confidential. The Board required ICG to file the material related to the tax ruling with the Board's ERO as provided in Section 62 of Act. In accordance with Section 60 of the Act, the ERO provided the Board with a summary of the ruling in memo form. As there were no objections,this was filed as an exhibit.

3.3.14 On December 14, 1987, Coopers & Lybrand received a favourable tax ruling from Revenue Canada, allowing ICG Ontario to use the CCA from the project against income. The ruling was given on the assumption that ICG Ontario is

the beneficial owner of the assets, but recognized that the project may be sold to either Boise or Hydro at some future date in accordance with provisions contained in the contracts.

3.3.15 On May 4, 1989, Coopers & Lybrand reapproached Revenue Canada and updated certain information concerning the project. A reply from Revenue Canada was received on July 31, 1989, which indicated that the update did not affect the previous ruling and also confirmed that the ruling would be binding, provided the proposed transactions were completed by December 31, 1990.

3.3.16 On June 28, 1988, EMR gave a 'prior opinion' that the project would, in principle, qualify for an accelerated CCA under Class 34. The filing of an application by ICG and certification by EMR is necessary before the CCA can be claimed.

3.3.17 ICG has structured the project to provide the maximum benefit to the cogeneration project from the tax ruling. ICG estimated that by using the CCA against utility income, rather than the cogeneration project's income alone, up to $35 million in tax deferrals could be generated in 1989, 1990 and 1991 and utilized to finance the project.

3.3.18 According to ICG, if the CCA were taken against income from the cogeneration project only, as in the alternative case, the tax deferrals would be greatly reduced, thus requiring a higher level of debt than in its proposed capital structure.

3.3.19 ICG stated that the net present value ("NPV") of the deferred taxes, due to timing differences between when these were to be received and repaid, amounted to $7.14 million in the case where utility income was used, compared to a stand alone project.

3.3.20 ICG's witnesses stated that, in the event of a sale of the cogeneration assets to Boise or Hydro, the sale price would include a provision for the repayment of the outstanding portion of the deferred taxes at the date of such sale.

3.3.21 ICG pointed out that the tax ruling was based on ICG Ontario being the beneficial owner of the assets and with only the potential sale to its partners in the project. If ICG Ontario were to 'roll-out' the project later into a separate legal entity, either by a sale of assets or the issue of shares, the basis of the tax ruling would be altered and could be invalidated. Witnesses from Coopers & Lybrand and Inter-City were called to address this matter.

3.3.22 ICG stated that obtaining the tax ruling had proved to be difficult, because Revenue Canada was concerned about the density of ownership of the cogeneration assets.

3.3.23 In response to considerable cross-examination by Board Staff on the subject, ICG stated that until the current proceeding had raised the issue, there had been no serious examination of 'rolling out' the assets after a period of time, either to an affiliate or to a third party. According to ICG, this would constitute a change in a material fact and would give cause for concern that the December 14, 1988 tax ruling would no longer be binding. Revenue Canada had confirmed they would wish to review such a change in the context of the original ruling.

3.3.24 ICG stated that in addition, any new ruling would likely come under the provisions of the new subsection 245-1 of the Income Tax Act which contains the General Anti-Avoidance Rule ("GAAR"). This would create additional risk that Revenue Canada could reconsider the nature of the transactions and find them to be, in substance, a financing transaction. This was more likely the earlier in the project that a 'roll-out' or sale was contemplated.

3.3.25 ICG stated that, as well as the risks of an unfavourable ruling from Revenue Canada if such an early 'roll-out' or sale were made, the project economics would be less attractive from the equity investor's perspective.

## 3.4 GAS SUPPLY ARRANGEMENTS

3.4.1 ICG informed the Board that based on a competitive tendering process, natural gas for the cogeneration project is to be supplied equally by two companies: ICGR and North Canadian. At the time of contract negotiations, ICGR was an affiliate of ICG Ontario and thus the gas supply contract required approval under article 3.0 of the 1988 Undertakings. ICGR is now owned by the Saskatchewan Oil and Gas Corporation.

3.4.2 The contracts executed between ICG and ICGR and North Canadian are long-term contracts terminating on October 31, 2005 and November 1, 2005 respectively. Each gas supplier will provide 50 percent of the maximum volume negotiated for the Cogeneration Division of ICG.

3.4.3 The agreements with Boise and Hydro provide that the cogeneration facility may be sold prior to the above termination dates to Boise or Ontario Hydro, (or "spun off" to a

subsidiary company of ICG Canada). If it is purchased by Boise, then ICG may assign the gas supply contracts to Boise without consent, but will require written releases from the gas suppliers of its obligations under these contracts. If, however, Ontario Hydro should purchase the facilities, consent to the assignment as well as written release of ICG's obligations under the gas supply contracts will be required from the gas suppliers.

3.4.4 Each gas supply contract provides for a Daily Contract Demand of 335 $10^3m^3$ with a 10 percent variation upwards and downwards, subject to certain terms and conditions. ICG expects deliveries from ICGR and North Canadian to commence as of November 1, 1990 or the date of project start-up and commissioning, whichever is later.

3.4.5 The delivery point for Alberta gas supply to ICG from ICGR and North Canadian will be on the TCPL system immediately east of the Alberta/ Saskatchewan border. North Canadian will also supply Saskatchewan gas to ICG at the points of interconnection between TransGas Limited's system and the TCPL system.

3.4.6 ICG's gas supply contracts with ICGR and North Canadian contain provisions to enhance the security of gas supply for the cogeneration project. Reserves will be dedicated to the performance of each contract and reviewed every two years.

3.4.7 The gas supply contracts stipulate an initial base price which is then subject to annual escalation based on Ontario Hydro's rate increases for large, direct, industrial customers. Also, two base price adjustments over the term of the contracts are provided for. These are intended to align the cost of gas supply closely to energy sales prices from the cogeneration project and the prevailing market prices for natural gas.

3.4.8 ICG has also executed transportation contracts with three carriers to transport the gas to its Fort Frances system through the facilities of TCPL, ICG Transmission and Inter-City Minnesota Pipelines Limited Inc.

## 3.5 PROJECT ECONOMICS

3.5.1 ICG presented information on project economics in the form of the calculated internal rate of return ("IRR" or "return on assets") and NPV,

assuming the project was structured as proposed. It also provided calculations assuming the project is held within a separate corporate entity owned by ICG Canada (i.e. outside the utility company) which would, therefore, not have access to tax deferrals generated by utility operating income, and would only have tax deferrals against income from the project itself.

3.5.2 Initially, ICG provided little information on the major assumptions on which it based its calculations, on the grounds that this could breach the confidentiality provisions in its contracts. In response to interrogatories and undertakings and a Board ruling on the matter, ICG provided more information on the key assumptions and provided internal rate of return sensitivities and also calculations of the return on shareholder's equity.

**Base Case Analysis**

3.5.3 ICG's base case assumes a capital structure as shown in Table 2, which results in an after tax weighted average cost of capital of 6 percent.

3.5.4 All operating costs, including fuel, escalate according to Hydro's forecast of power cost.

Every 5 years the gas contract price is adjusted within certain limits to market value, and ICG has assumed the maximum 25 percent increase in these years. Increases in gas costs are assumed to be allocated 56 percent to Hydro as increased prices for power, 22 percent to Boise as increased prices for steam and 22 percent to ICG as increased operating cost.

TABLE 2

ICG'S BASE CASE COST OF CAPITAL
AND RETURN ON ASSETS

| Capital Component | Assumed % | Cost % | Cost Component % |
|---|---|---|---|
| Debt (Hydro loan) | 45 | 4 | 1 |
| Equity (Inter-City) | 20 | 25 | 5 |
| Deferred Taxes (ICG) | 35 | 0 | 0 |
| Weighted Average Cost of Capital (WACC) | | | 6 |
| Calculated Project IRR (Return on Assets) | | | 10.8 |

3.5.5 Board Staff and others questioned ICG extensively as to whether its base case was conservative to an unreasonable degree. ICG maintained that it was not.

**Alternative Case Analysis**

3.5.6 In its alternative case, ICG assumed that the Cogeneration Division was a separate legal entity within the structure of ICG Canada, its shareholder's utility holding Company. ICG assumed that no deferred taxes could be generated to finance the project and, accordingly, $35 million of additional debt would be issued at a coupon rate of 12 percent, resulting in an after tax cost of 6.7 percent for this component of capital, and a WACC of 8.35 percent. Other assumptions used were the same as for the base case.

3.5.7 The calculated IRR for this case was 7.8 percent.

3.5.8 ICG stated that the alternative case was not economically viable since the cost of capital exceeded the return on assets generated by the project.

3.5.9 ICG's assumptions and its conclusion that the alternative case was not viable were challenged in cross-examination by Board Staff and others, who suggested that other financial structures based on other assumptions could make the alternative case, or variations thereof, viable.

**Sensitivity Analysis**

3.5.10 ICG provided a sensitivity analysis of the base case calculated project IRR to the principal risk of a permanent shut-down of Boise's pulp and paper mill in years 3 through 7 corresponding to 1992 to 1999. This showed that, due to contractual provisions for Boise to pay ICG liquidated damages, the project IRR only decreased by up to one percentage point and the project remained economically viable.

3.5.11 ICG did not present similar analyses for the alternative case, but indicated that, directionally, the same order of magnitude effect would occur, with the result that the project became even less economically viable.

## 3.6 SHAREHOLDER CONSIDERATIONS

3.6.1 As of December 31, 1988 there were 17,860,630 outstanding common shares issued by ICG Ontario, corresponding to a book value (December 1988) of $7.89 per share. ICG Ontario's shares are held exclusively by ICG Canada and, therefore, there are no general public stockholders and no trading in the shares of ICG Ontario, which would provide an indication of the market value of ICG Ontario's common equity.

3.6.2 Currently the Board has deemed that an appropriate equity component associated with ICG Ontario's utility operations is 36 percent of the total capital structure, based on the Board's authorized rate base of $399 million in E.B.R.O. 440 (February 1988).

**Equity Investment in Cogeneration Project**

3.6.3 ICG provided evidence which showed that the equity component of ICG Ontario, on a consolidated basis, is currently about 40 percent and the equity component of its non-utility investments would be about 23 percent including the cogeneration project.

3.6.4 Witnesses for ICG testified that the equity investment in the ICG/Boise cogeneration project will be approximately 20 percent or about $18 million, based on the most likely capitalization of the project. In return for Inter-City providing this equity through ICG Canada, ICG Ontario will issue additional common shares to ICG Canada. Although ICG did not explicitly specify the price and hence the number of such shares, it was implied that the issue would be according to present book value which, by the Board's estimate, would yield approximately 2,282,000 shares, thereby increasing the outstanding common shares by this amount.

3.6.5 There was no indication that ICG Canada would provide any shares or other instrument to Inter-City in return for the equity provided and, in any event, with the proposed sale of ICG Canada to Westcoast, this is now a consideration for the Directors of Westcoast. The Westcoast sale, and its ramifications for the ICG/Boise project, are discussed briefly below.

**Return on Shareholder's Invested Equity**

3.6.6 In its E.B.R.O. 440 Decision dated February 19, 1988, the Board authorized ICG to earn a 13.5 percent rate of return after tax on the deemed utility common equity component of 36.0 percent. Rates were set to recover the costs of ICG's utility operations and to allow an opportunity for ICG's shareholder to earn this rate of return on common equity.

3.6.7 The dividend policy of ICG is set by its Board of Directors and is not directly subject to review by the Ontario Energy Board. Therefore, the shareholder's actual return on common equity invested in the utility is determined by the actual operating results of the utility operations and the dividend policy established by ICG's Board of Directors.

3.6.8 ICG Ontario's witnesses submitted that the economics of the cogeneration project are unacceptable to the shareholder unless ICG is permitted to own and operate the cogeneration facility as a division of ICG Ontario, in order to obtain the financing benefit from the accelerated write-off of Class 34 assets against ICG Ontario's income. ICG Ontario argued that any sharing of cogeneration profits with utility ratepayers, or the removal of the project from ICG Ontario into a separate corporate entity (roll-out) before the end of the 15-year period of ICG Ontario's planned ownership of the project, would adversely affect the project's economics.

3.6.9 ICG Ontario's evidence was that, if authorized to undertake the cogeneration investment as a division of the utility and thereby use the income from the utility operations and the accelerated CCA from the project to generate deferred taxes, and assuming a 100 percent dividend payout policy, the shareholder (ICG Canada) could expect to earn a return of approximately 20.5 percent after tax on its $18 million equity investment. This would be acceptable to the shareholder. In the view of Mr. Falconer, the expert witness appearing on behalf of ICG Ontario, this would be a low

return, bearing in mind that it relates to a new project, but nonetheless is appropriate, in his view, considering the financial and business risks of the cogeneration project.

3.6.10 The return of 20.5 percent assumes the reinvestment of surplus cash at short-term rates. ICG Ontario stated that an alternative assumption of reinvestment at the average cost of capital for ICG Ontario would achieve a similar result.

3.6.11 Mr. Anderson, appearing as an expert witness for Northland Power, stated that a more appropriate assumption was that the surplus funds generated by the cogeneration project would be reinvested at the same return earned by the project, approximately 20 percent, rather than the short-term rate of 12 percent.

3.6.12 ICG Ontario submitted that this was an inappropriate assumption if ICG Ontario owned the cogeneration facility, but could be appropriate if the facility was owned by a corporate entity other than ICG Ontario. However, Mr. Falconer disagreed with Mr. Anderson's proposition, even if the cogeneration project was owned outside ICG Ontario. ICG Ontario stated that Mr. Falconer's view was

both conservative and appropriate when considering its investment in the cogeneration project.

3.6.13 In comparison with the base case return of 20.5 percent stated above, ICG determined that on a stand alone ownership basis without the benefit of the deferred taxes available from using the utility income (estimated to be $7.145 million on an NPV basis), the return to Inter-City would be approximately 13.4 percent after tax, with surplus cash being invested at the short-term rate. If the projected rate of return of approximately 20 percent were applied to surplus cash, Mr. Anderson calculated a return on equity of approximately 17.3 percent. In Mr. Falconer's view such a return was still too low to continue the project. ICG Ontario argued that Mr. Anderson had not considered the payback period which, on a stand alone basis, would be unreasonable because of the inability to utilize the accelerated capital cost allowance.

**The Transfer of Inter-City's Interest in ICG Canada to Westcoast**

3.6.14 ICG did not provide any details of either the proposed transfer of Inter-City's interest in ICG Canada and hence ICG Ontario to Westcoast,

or of its ramifications for the ICG/Boise Cogeneration project.

3.6.15 Upon questioning by parties to the hearing, ICG stated that the obligation of Inter-City to invest up to 20 percent as equity in ICG Ontario for the cogeneration project through ICG Canada would be assumed by Westcoast. ICG filed a letter dated September 5, 1989 which expressed this intention. However, ICG stated that no legally binding commitment was, as yet, in place and indicated to the Board that Westcoast may seek to renegotiate this commitment if there was any material change to the structure of the project.

## 3.7 RISKS TO THE UTILITY AND ITS RATEPAYERS

3.7.1 ICG stated that the Board should be primarily concerned with protection of the utility ratepayers from risks associated with the cogeneration project and that it was confident the structure of the Boise project and its contractual provisions are such that the utility operations and ratepayers are at minimal risk.

3.7.2 ICG stated that it had examined the potential risks to its utility operations arising from the cogeneration project. These included

direct risks from the project in the form of cash flow deficits, and contract related liabilities. It also considered capital related risks such as effects on overall capitalization of the Company, the debt rating of ICG Ontario and the position of its bond holders.

3.7.3 ICG stated that these risks had been carefully considered and were either covered by contractual indemnities or were assessed as 'de minimis' by its financial advisors.

3.7.4 Although it contended that the risks to its utility operation were minimal, ICG indicated that the shareholder was willing to indemnify the ratepayers for any and all risks attributable to the cogeneration project.

3.7.5 On the other hand, ICG submitted that there was a direct financial benefit to the utility operations and ratepayers, amounting to some $750,000 annually from the project. Other benefits, including market retention, although less tangible, were also expected to be realized.

3.7.6 Mr. Falconer stated that his Company had reviewed the financial forecasts for the cogeneration project and the projections of

future capitalization of ICG Ontario provided by ICG. He stated that he had not reviewed ICG's alternative case since he was of the view that the returns were too low and ICG would not be interested in investing.

3.7.7 Mr. Falconer indicated that the projected IRR in ICG's base case was quite low for a new project with the level of risk of the cogeneration plant. He also indicated that the shareholder's return on equity of approximately 20.5 percent was 'low but reasonable' under the circumstances. He attributed his conclusions to the relatively low net income (profit) demonstrated by the project in the early years which depressed the return on capital and equity in those years. He noted the project risks were lower than he first thought because of the nature of the contractual arrangements negotiated by ICG.

3.7.8 Mr. Falconer also stated that, based on the capitalization projections for ICG, he had concluded that the cogeneration project should not adversely affect the credit rating of ICG Ontario. Further, he said that, over time, the project may strengthen ICG.

3.7.9 He also indicated that two presentations had been made to the credit rating agencies, Dominion Bond Rating Service ("DBRS") and Canadian Bond Rating Service ("CBRS"). ICG is currently 'split rated' with CBRS ratings of B++ on debentures and P3 on preference shares, and DBRS ratings of A(low) on debentures and P2 on preference shares.

3.7.10 Based on these meetings between ICG and CBRS and DBRS, the agencies had maintained ICG's credit rating and ICG had been able to float an issue for $75 million of 20-year debentures at an interest rate of 10 3/4 percent or about 132 basis points over long Canada Bonds. This interest rate was a competitive one and corresponded more closely to the A(low) rating of DBRS, being only about 8 basis points above a typical A(low) interest rate.

3.7.11 Mr. Falconer indicated, in response to Board Staff questioning, that since ICG is "on the edge" with its credit ratings, the performance of the cogeneration project was very important. If ICG were to slip to a straight B++, not only would its cost of capital rise but it may also have difficulty raising capital in a tight capital market situation.

## 3.8 BOARD FINDINGS ON THE ISSUES IN THE HEARING

### Policy Considerations

3.8.1 The Government of Ontario has stated that it believes firmly in the benefits to energy policy and economic development associated with maximizing the amount of economic private generation connected to Hydro's system. It also, as noted above, views the pulp and paper sector as having a major potential contribution to non-utility generation, and sees natural gas as a desirable fuel for power generation for some years in the future.

3.8.2 The Government's concern about diversification and non-utility investment by the regulated utilities in Ontario and the risks that this could pose for the utility operations and gas customers, is clear from the undertakings executed between the utilities and the Government. Each of the major utilities have signed undertakings which, as a basic principle, restrict investment in non-utility assets by the regulated gas utility. In the case of ICG Ontario, this is specifically contained in Article 5.4(a) of the Undertakings while Article 5.4(b) also requires that specific action be taken to move ICG Ontario towards becoming a "pure" utility.

3.8.3 To the extent, therefore, that the Undertakings reflect a public policy perspective, it is clear to the Board that a "pure" utility structure is most desirable.

3.8.4 As evidenced in its previous decisions, the Board is supportive of non-utility generation and cogeneration, and recognizes the potential for gas-fired generation facilities to improve the load factor of gas distribution companies to the benefit of utility customers. However, there is no evidence that such benefits are contingent upon investment by a gas utility or its shareholders in non-utility power generation in ways which conflict with the Undertakings to which these companies are signatories.

3.8.5 **The Board concludes that, in the light of the principles reflected in the Undertakings given to the Lieutenant Governor in Council, the onus is clearly on ICG Ontario to prove that a departure from the pure utility principle embodied in the Undertakings is necessary and desirable from a public interest perspective, and that the specific project requires such an exemption and poses no potential risk to the utility or to its ratepayers.**

3.8.6 **The Board also concludes that the onus is on ICG Ontario and its shareholders to prove that no other structure would allow the project to proceed on a stand alone basis, thereby not posing a conflict with the Undertakings.**

3.8.7 The Board also notes that, although not examined as part of the current reference, questions were raised by the independent power industry in Ontario as to whether the regulated gas utilities should be directly involved in the non-utility generation and cogeneration businesses. It appeared that those questions related to the potentially unfair competitive position of the gas distribution companies because of their access to gas supply and capital markets which result from their regulated utility operations. The Board believes that this issue should be examined further by the Government, perhaps under the auspices of the Non-Utility Generation Committee of the Ministry of Energy.

**Structure of the Cogeneration Investment**

3.8.8 In structuring the cogeneration project in an operating Division of ICG Ontario, as proposed, the utility company assumes all of the legal liabilities and contractual obligations of the project. Also, there is no separation of the

financial liabilities, including cost of capital market effects, from the utility's operations. The utility company is almost exclusively the regulated gas utility. Indeed, since the reorganization involving the GWG assets, the utility is currently the only operating Division of ICG Ontario. The main source of operating funds for ICG Ontario, other than debt and shareholders' equity, is utility income.

3.8.9 In the Board's view, there are three main issues associated with ICG's proposed structure, which relate directly to the Undertakings:

(i) the investment by ICG Ontario in a non-utility, non-regulated business and its proposal to hold this non-utility investment as a division of the utility company, not as a separate legal entity (5.4(a));

(ii) the directional change to a diversified company (5.4(b)); and

(iii) the risks to ICG Ontario, and hence to the utility operations, from the liabilities and obligations of the Cogeneration Division (5.4(a) and (b)).

3.8.10 It appears to the Board that the key considerations, for structuring the project in the way proposed by ICG Ontario, are the project economics and the return on the shareholder's investment.

3.8.11 The tax ruling obtained from Revenue Canada was received on the basis of ICG Ontario being the beneficial owner of the project, and allows for the potential sale of the project assets to Boise Canada, a taxable Canadian corporation, or to Hydro, a non-taxable corporation.

3.8.12 **The Board finds that ICG Ontario has not proved to the Board's satisfaction that a similar tax ruling could not have been obtained for a project structured outside the utility company as part of ICG Canada.**

3.8.13 **In addition, the Board finds that there is no patently obvious reason why the Cogeneration Division could not be structured as a 100 percent-owned subsidiary company of ICG Ontario.**

3.8.14 The Board is of the opinion that it was not in either ICG's interest or in the public interest to wait until the cogeneration project was well underway and structured in such a manner that the consequences of a failure to obtain the

requested exemption would, as claimed by ICG Ontario, be serious or even disastrous for ICG and the cogeneration project.

**Project Economics**

3.8.15 The Board is satisfied that ICG Ontario has demonstrated that under its base case, the cogeneration project is economically viable, based on an evaluation of the project's return on assets, under a reasonable and conservative set of base case assumptions. The project also appears to remain economically viable under a "worst case" scenario involving permanent closure of Boise's mill, because of the contractual provisions for Boise to pay liquidated damages to ICG.

3.8.16 The Board is not satisfied that ICG has adequately demonstrated that under its alternative stand alone case, or realistic variations of that case, the project could not also be economically viable. The difference in IRR and NPV between the base case (within ICG Ontario) and the alternative case or variations thereof would be narrowed in the event that different, but plausible, assumptions about the capital structure of the alternative case were used, and if ICG were less conservative in forecasting costs, revenues and taxes payable.

3.8.17 The Board concludes that ICG has failed to demonstrate satisfactorily that the project could not be economically viable if undertaken on a stand alone basis either outside the utility company or as a wholly-owned subsidiary of ICG Ontario. ICG has demonstrated only that the project is less attractive, from its shareholder's viewpoint, if structured in accordance with its chosen alternative of a stand alone project. The Board also concludes that the shareholder's return on equity is the main driving factor for ICG's proposed structure of the cogeneration investment.

Shareholder Considerations

3.8.18 The Board has authority under Section 19 of the Act to provide, through rates, for an opportunity for shareholders to earn a fair rate of return on their equity invested in ICG's utility operations.

3.8.19 For non-utility investments which are not legally separated from the utility, the Board's role is to ensure that they are not cross-subsidized by the utility's ratepayers. Therefore, the Board deems, in each rate case, appropriate amounts to be excluded from the utility assets (rate base) and net income. The

Board also determines the taxes to be allowed for in setting the amount to be recovered in rates by the regulated utility.

3.8.20 The Board has no authority over, and is not concerned with, the common equity component of capitalization and the rate of return on common equity associated with non-utility investments, if these are held in a separate legal subsidiary. The Board's role in this situation is to ensure that the overall equity ratio of ICG is adequate to provide the deemed equity component for the capital structure of the regulated activity and to ensure that non-utility investments or other financial activities of the shareholder do not adversely affect the utility ratepayers.

3.8.21 The Board makes no finding with respect to the proposed issue of shares in return for equity capital, since ICG Canada is the sole shareholder of ICG Ontario and no public stockholders are involved. The Board also makes no finding in respect of ICG's estimates of returns on the shareholder's equity if the project is undertaken either as proposed, (including with the accounting treatment requested) or if undertaken on a stand alone basis.

**Risks to Utility and Ratepayers**

3.8.22 In the Board's view, there are a number of generic risks to a regulated utility and its ratepayers which are introduced when the shareholder(s) of the utility invest in non-utility assets. The relevance and degree of these risks is dependent on the nature of the non-utility business, i.e. whether it is related or unrelated to the utility business of the company. The structural (legal, management and financial) relationships between the non-utility investment and the regulated utility are also of paramount importance.

3.8.23 Possible corporate structures relevant to these relationships include:

(i) a separate legal entity outside the corporate entity which holds the regulated utility;

(ii) a separate legal entity wholly-owned by the corporate entity which holds the regulated utility;

(iii) a wholly-owned subsidiary of the regulated utility; and

(iv) a division within the regulated utility.

3.8.24 In the Board's view, the risks to the utility increase the closer the relationship moves towards being part of the regulated utility.

3.8.25 The direct risks to the utility associated with a non-utility investment may include:

a) operating deficits;
b) tax liabilities;
c) contractual liabilities; and
d) inequitable intercorporate or affiliate transactions.

3.8.26 The indirect risks to the utility associated with a non-utility investment may include:

e) cost of capital, bond rating, etc.;
f) diversion of management time and expertise;
g) diversion of shareholder attention and increased return expectations;
h) changing the nature of the company's business; and
i) goodwill effects.

3.8.27 Since the utility may also be lending its credit capacity and business reputation to non-utility businesses, the credit rating and goodwill associated with the regulated utility

are likely to be beneficial to the investors in the non-utility business. This raises an issue of appropriate compensation, if any, to be paid to the utility ratepayers.

3.8.28 A number of mechanisms exist which, in the Board's view, either alone or in combination, could provide a degree of protection to the regulated utility and its ratepayers from any adverse effects of a non-utility investment. These include:

(i) The corporate "picket fence" approach of establishing the non-utility investment in a separate arms-length company outside the utility operating company;

(ii) the undertakings approach whereby, as a result of signing undertakings, the utility company is prohibited from making non-utility investments except with the approval of the regulator and, given such approval conditioned as necessary, the utility and its ratepayers are indemnified against any adverse effects arising from the non-utility investment; and

(iii) monitoring and review by the regulator of all non-utility investments.

3.8.29 In the Board's opinion, alternative (iii) poses difficulties in that the public nature of the Board's proceedings make it difficult to maintain the confidentiality of information pertaining to non-utility investments. Furthermore, monitoring non-utility investments could become as time-consuming for the regulator as the regulation of utility rates, particularly if non-utility investments became significant, thereby changing the fundamental business and financial nature of a regulated utility.

3.8.30 The Board holds that direct risks in respect of prudent non-utility investments can be minimized or eliminated by structuring such investments in a legal entity separate from that holding the regulated utility. This could be owned directly or indirectly by the consolidated entity holding the utility. The indirect risks, however, can only be minimized if the non-utility investment is owned on a stand alone basis outside the corporate entity owning the regulated utility. In any event, the Board believes that, even on such a stand alone basis, some of the indirect risks may not be completely eliminated.

3.8.31 **The Board concludes that ICG has made efforts to minimize the direct risks to the utility**

ratepayers from the cogeneration project, but as long as the project is part of ICG Ontario, some direct risks remain. The indirect risks are less tangible and therefore more difficult to protect against and can only be minimized by the financial and legal separation of sizeable non-utility investments, such as the cogeneration project, from the regulated utility.

## 3.9 BOARD FINDINGS AND CONCLUSIONS REGARDING THE REQUESTED EXEMPTION TO ARTICLES 5.4(a) AND (b) OF THE UNDERTAKINGS

3.9.1 The Board finds that if the Boise cogeneration project, structured as ICG proposes, had been the subject of an approach to the Board as a "green field" project, i.e. before any commitment had been entered into or any construction dollars spent, the Board, having reviewed the project in depth as part of its "due diligence", would have recommended against an exemption to Article 5.4(a) of the Undertakings on the basis of the evidence in this hearing.

3.9.2 This recommendation would have been based on the following considerations:

(i) the availability of other corporate structures for the cogeneration project investment which pose little risk to the

utility or its ratepayers, and ICG's failure to prove that, for reasons other than shareholder returns, these were not practical;

(ii) the desirability of retaining as "pure" a utility as possible, as reflected in the 1988 Undertakings;

(iii) the risks which remain to the utility and hence the ratepayers under ICG's proposed structure, despite ICG's attempts to minimize them; and

(iv) the major complications, under ICG's proposal, of regulating the utility function of ICG Ontario as the owner of both the utility and non-utility functions.

3.9.3 **The Board finds, however, that the project has been under construction before either the original application in April 1989 or the reference from the Lieutenant Governor in Council was received. The original application to the Board by ICG for exemptions to the 1988 Undertakings was dated April 10, 1989, and the Lieutenant Governor in Council's reference to the Board was dated June 12, 1989. It is clear to the Board that considerable sums of money**

were spent, and commitments entered into, long before the Board could have responded to either ICG's application or the Lieutenant Governor in Council's reference. The evidence in the hearing showed that by the end of June 1989 some $18 million had been spent or committed and that, by the end of December, 1989, approximately $58 million will have been spent or committed. By that date, it is expected that the project will be more than half-built.

3.9.4 The Board concludes that for ICG, in respect of its April 1989 application, to place the public interest examination of the project in almost a post-facto mode is a breach both of the letter and spirit of the 1988 Undertakings.

3.9.5 The Board concludes that it is clear from the Undertakings that any dispensation from the obligations of Article 5.4 shall be obtained from the Board before the otherwise forbidden non-regulated activity is embarked upon. The Undertakings were entered into for the sole purpose of protecting utility ratepayers from the effects of such non-utility investments.

3.9.6 The Board finds that its role as the Lieutenant Governor in Council's agent pertaining to the requested exemption to Article 5.4, a role which the Undertakings require the Board to

perform, is severely, if not entirely, constrained in this case. In the Board's view, the government of Ontario, by virtue of its public statements, has already explicitly approved ICG's action of contravening its undertaking to the Lieutenant Governor in Council not to invest in an otherwise forbidden activity without prior exemption from the ban.

3.9.7 The Board, therefore, has no remaining role to play in respect of whether an exemption to Article 5.4(a) is warranted. However, since Board approval of ICG's investment is technically required, the Board recommends that dispensation be granted in accordance with the provision of Article 5.4 (c) of the Undertakings.

## 3.10 BOARD FINDINGS REGARDING CONDITIONS OF LIEUTENANT GOVERNOR IN COUNCIL APPROVAL

3.10.1 The Board's role in recommending Conditions of Approval arises because:

a) the Board, as agent for the Lieutenant Governor in Council, must advise upon the matters relevant to the implementation of the Undertakings in order to ensure that both the letter and spirit of these are adhered to by ICG and the

companies which control ICG and, if an exemption are to be granted, to recommend such conditions as are appropriate to attach to such exemptions; and

b) the Board has a mandate both as agent for the Lieutenant Governor in Council in respect of the Undertakings and also, in its own right, under the Act, to protect the regulated utility and its ratepayers from any adverse effects of non-utility investments, and to ensure that rates at all times are just and reasonable.

3.10.2 Through the passage of events, the matters reviewed by the Board in the hearing may now be irrelevant to the question asked of the Board by the Lieutenant Governor in Council as to "whether an exemption should be granted ICG from Article 5.4 of the 1988 Undertakings". The Board believes that the Lieutenant Governor in Council's reference encompasses a review of the way in which ICG has structured the project and hence how ICG should be allowed to proceed with the project. Accordingly, the Board's findings are directly relevant to the issue of the conditions which the Board believes the Lieutenant Governor in Council should attach to his formal granting of the requested dispensation.

3.10.3 Accordingly, the Board has carefully considered the conditions which it will recommend that the Lieutenant Governor in Council should attach to the granting of dispensation, in order to ensure that the Undertakings are more effective in future and that utility ratepayers are protected from any adverse effects that may result from granting of the requested dispensation.

Amendments to the 1988 Undertakings

3.10.4 The Board finds that neither the wording nor the intention of Article 5.4 provide that exemptions can be sought after the fact for investments which are substantially, or even partially, complete.

3.10.5 The Board concludes that the effective future implementation of Article 5.4 of the Undertakings clearly requires prior authority to invest in a non-utility activity. There should, therefore, be an amendment made to Article 5.4(c) to ensure that the requirement for prior approval is made explicit for the signatories to the 1988 Undertakings.

Risk Minimization

3.10.6 The Board finds that the significant size and structure of the ICG/Boise Project pose an

increased risk, particularly in the earlier years of operation, to ICG, its utility operations and its ratepayers in northern and eastern Ontario. The Board is satisfied that the direct risks have been mitigated significantly by the negotiated contractual provisions, and that the project's economics are basically sound. However, the Board is not convinced that the indirect risks are either well understood by ICG or that there is any plan to mitigate them except 'post facto', by a promise of indemnification of the ratepayers by the shareholders.

3.10.7 The Board concludes that indemnification alone is inadequate protection, due to the difficulty of quantifying the indirect risks of the project. Risk minimization by an appropriate advance structuring of the project is, in the Board's view, essential. Financial risks remain as long as the cogeneration project is within ICG Ontario and it is incumbent on the parties to the Undertakings to ensure that the risks to the utility associated with the project are minimized as far as possible.

3.10.8 The Board concludes that risk minimization can only be accomplished by re-structuring the cogeneration investment, as a separate legal entity outside of the utility and owned by ICG

Canada. Given the advanced state of the project, the Board concludes that ICG should now establish the project as a wholly-owned subsidiary of ICG Ontario. This is necessary to contain the legal and financial risks as far as possible within the structure of the cogeneration project. An additional consideration is the considerable difficulty that such a sizeable non-utility investment, if not so structured, will pose to the Board in determining the utility rate base, revenue requirement and cost of capital in order to set just and reasonable rates for ICG's gas customers. The Board is well aware of these difficulties and it was, in part, consideration of such problems that gave rise to Article 5.4(b) of the Undertakings and the eventual removal of the GWG investment from ICG Ontario.

3.10.9 The Board concludes that although structuring the project in a separate legal entity will reduce the shareholder's benefit associated with the deferred taxes proposed to be generated by using the project's Class 34 CCA against utility income, the risks associated with not having the cogeneration project as a separate legal entity far outweigh this shareholder consideration.

3.10.10 The Board points out that all gas utilities in Ontario have structured their active major non-utility investments in separate legal entities for good and valid reasons.

3.10.11 The Board finds that a separate legal entity owned by ICG Ontario constitutes the minimum material change to the structure of the project that is necessary to protect the utility and its ratepayers and yet allow the Board to carry out its mandate under the Act with a minimum of complications. The Board believes that the facts presented to Revenue Canada and the parties to the contracts would undergo a minimum change under such a restructuring.

3.10.12 The Board also concludes that even though the risks are mitigated by structuring the project as a separate legal entity, sufficient risks remain that ICG must, as stated in the hearing, indemnify the utility ratepayers from any and all financial risks and effects of the cogeneration project. Together with the proposed restructuring of the project, this should serve to provide a reasonable degree of protection to the utility ratepayers.

## 3.11 BOARD FINDINGS WITH RESPECT TO THE EXEMPTION TO ARTICLE 3.0 OF THE UNDERTAKINGS

3.11.1 Although ICGR is now owned by the Saskatchewan Oil and Gas Corporation, and accordingly is a non-affiliated company, the gas supply contract was negotiated at a time when ICGR was an affiliate of ICG. Hence ICG's request to the Lieutenant Governor in Council for the Board to recommend approval of the transaction under Article 3.0 of the Undertakings.

3.11.2 Undertaking 3.0 states that approval shall not be withheld if the transaction is shown to be of benefit to ICG Ontario or takes place at or below market value. Due to reasons of commercial sensitivity, ICG did not produce the contract nor did it reveal the price contained therein. The issue received little attention at the hearing since, the Board suspects, it was considered of lesser importance to the other issues. In any event, no party to the hearing argued that the price contained in the contract is not or may not be a market price.

3.11.3 The Board finds that there is evidence that the ICGR contract provides for gas supply at no more than a fair market price, based on ICG's process of selection, which involved tendering, and the fact that ICG stated that both Boise

and Ontario Hydro are satisfied with the contract's terms. This finding should not, however, be taken as precluding the Board's further examination of the prudency of ICG's gas supply arrangements for the project in future rate cases.

## 3.12 RECOMMENDATIONS

1. The Board recommends that the Lieutenant Governor in Council formally grant the request from ICG Utilities (Ontario) Ltd for an exemption to Article 5.4 of the 1988 Undertakings to allow ICG to invest in the 100MW Cogeneration project situated on the premises of Boise Cascade Canada Ltd. in the town of Fort Frances, Ontario; this dispensation to be made conditional upon ICG Ontario, its shareholders and parent Companies which control ICG Ontario:

   a) executing an amendment to Article 5.4(c) of the 1988 Undertakings which will require ICG Ontario to obtain dispensation of the Lieutenant Governor in Council, upon recommendation of the Board, for any new non-utility investment. 'Dispensation' means prior approval i.e., before any binding contractual obligations are

entered into by ICG Ontario, its parent companies and affiliates, or any funds are expended other than for project feasibility assessment.

(b) as soon as possible, by a date to be agreed with the Lieutenant Governor in Council, establishing the cogeneration project in a legally and financially separate corporate entity which may be owned by ICG Ontario, rather than as an operating Division of the utility company.

(c) executing an undertaking to indemnify the regulated utility and its ratepayers against all direct and indirect liabilities and any additional costs arising from ICG's non-utility investments as defined by the Ontario Energy Board, including, but not limited to, the Cogeneration project.

2. The Board recommends that the Lieutenant Governor in Council grant ICG Ontario the requested exemption to Article 3.0 of the 1988 Undertakings in respect of the gas supply contract for the cogeneration project with ICG Resources Inc.

3. The Board recommends that the Government clarify its policy on the role of gas utility companies in developing non-utility electric generation projects in Ontario. In so doing, the existing undertakings given to the Lieutenant Governor in Council by these Companies should be reviewed.

# 4. SEPARATION AND ACCOUNTING ISSUES

## 4.1 INTRODUCTION

4.1.1 As part of its request to the Lieutenant Governor in Council, ICG Ontario asked that:

> "the Lieutenant Governor in Council require the Board to examine in a public hearing and report on whether a regulation should be made separating for ratemaking purposes, ICG's investment in the cogeneration project and the resulting tax deferrals from ICG's regulated gas distribution activities;"

4.1.2 Since the Reference did not require the Board to examine the proposed regulation, the Board will focus in this Chapter on the questions in respect of the proposed separation and the accounting treatment requested by ICG. It will however, in Chapter 5, provide the Lieutenant Governor in Council with its advice on the matter of the proposed regulation, which became an issue in the Hearing.

4.1.3 The Lieutenant Governor in Council asked the Board to examine and after holding a public hearing to report on:

whether

(i) in the determination of the rate base of ICG for the purposes of Section 19 of the Act, the cogeneration project and all property which is used or useful in the construction or operation of the cogeneration project should be excluded;

(ii) in the determination of the income of the utility operations of ICG for the purposes of Section 19 of the Act, all revenues and expenses which are attributable to the cogeneration project should be excluded;

(iii) for the purposes of Section 19 of the Act any tax savings or tax deferrals which are realized by ICG and are attributable to the tax treatment under the Income Tax Act (Canada) of the Cogeneration Project, including, without limiting the generality of the foregoing, any capital cost allowances claimed by ICG under the Income Tax Act (Canada) in respect of the Cogeneration Project should not be applied by the Board:

- to reduce the amount otherwise determined, for the purposes of section 19 of the Act, to be income taxes in respect of the utility operations of ICG, or

- to reduce the rates and other charges that would otherwise be payable by customers of ICG for the sale, transportation and storage of gas.

4.1.4 ICG stated that the reason for divisional rather than legal separation of the cogeneration project and the proposed segregation of the project assets, income and tax benefits, was to allow it to use the income from the utility operations as well as from the cogeneration project to generate tax deferrals for the cogeneration project. This would assist in financing the project and thereby increase the net income and shareholder return from the project beyond that available from utilizing the project income alone.

4.1.5 ICG stated that the proposed use of the utility income provided a benefit to the cogeneration project in the form of $35 million in deferred taxes in 1989, 1990 and 1991 which would be used to partly finance the project. It also increased the cash flow to the shareholder by approximately $7.14 million (NPV) over the life

of the project, above and beyond that available if the cogeneration project was to stand alone.

4.1.6 ICG stated that it had structured the project as another Division of the utility company principally in order to realize these tax-driven benefits.

4.1.7 ICG stated that it intended to achieve separation of accounting, banking, staff and service functions from the utility, but not legal separation. It also indicated it was willing to track and report to the ERO on any significant intra-corporate transactions and, as required by the Board, in future rate cases.

4.1.8 ICG did not provide the level of detail that is usual when requests for approval of certain accounting treatments are made in proceedings before the Board. Rather, it outlined the principles it was seeking to establish:

(i) the assets of the cogeneration plant would be excluded from the Board's consideration of the utility's rate base;

(ii) the income from the cogeneration project would be excluded from the Board's consideration of the utility's income requirement;

(iii) the capital cost allowance associated with the project's Class 34 assets would be utilized against the total income of ICG Ontario, including income from its utility operations, in 1990, 1991, and 1992 to generate deferred taxes by a reduction in taxes payable in those years;

(iv) the deferred taxes would result in an increase in an accounting net income in 1990, 1991 and 1992 which would provide a source of capital financing by streaming this additional "income" to the cogeneration project; and

(v) the deferred tax liability would be repaid in future years from ICG's taxable income from its utility operation, cogeneration project and other non-utility investments.

4.1.9 ICG did not provide details of the effects of these principles on the utility at the accounting level, but did provide, for the period 1989-1994, proforma projections of the year-end balance sheets and income statements for the cogeneration project and utility operations. These data were not explained in the context of the proposed accounting treatment, but rather in the context of the overall financial

integrity of ICG when the cogeneration project was in operation.

4.1.10 Parties to the hearing concentrated on the issue of whether the principles ICG was setting forth were fair and equitable to the utility ratepayers, and on the issue of whether the ratepayers should be compensated for the use of utility income to generate deferred taxes resulting in a net benefit of $7.145 million to the shareholder. ICG contended that this benefit was at the expense of Revenue Canada and not its utility ratepayers.

4.1.11 There was consensus among parties not representing gas utilities that ICG's proposals, particularly the tax treatment, were not appropriate. There was less consensus on whether the proposed principles should be denied, whether they should apply, under Board control, as part of the Board's regulation of the utility, or whether ICG's proposals should be allowed with compensation to the utility ratepayers for the benefit which the shareholder expected to receive if the principles were allowed as a basis for accounting. The gas utility company representatives, on the other hand, supported ICG's proposals as being prudent tax planning and an appropriate use of government incentives.

## 4.2 BOARD FINDINGS

4.2.1 In the Board's view, its primary concern in respect of the cogeneration project, must be the protection of the utility function of ICG Ontario and utility customers in Ontario from any risk associated with the project. ICG Ontario referred to "minimal" risks and submitted that the proposed divisional separation will ensure that such risks will not occur. The Board, however, must take a more cautious view and has reviewed the potential risks in Chapter 3.

4.2.2 A secondary consideration for the Board is the benefit to the utility ratepayers. ICG Ontario submitted that the benefits, accruing to the utility from the cogeneration project, such as delivery charges and the lower overall cost of gas, should be assessed against any additional risks. The Board, however, observes that these benefits are likely to accrue to the utility regardless of whether a divisional or corporate separation of the cogeneration function is created. The Board also observes that ICG Ontario's assurances that future cogeneration projects will be developed outside the utility appear to be much less firmly expressed in the hearing and in its argument than they were in its prefiled evidence.

4.2.3 The Board concludes that separation of the facilities divisionally in the manner proposed by ICG Ontario appears to be the only way that the extra shareholder benefit of approximately $7.14 million can be achieved with certainty. The Board points out, however, that the use of allowable tax credits from the project will be available, in any event, but over a longer time span. It is the benefit of the time value of money that the shareholder would enjoy through ICG Ontario's proposal. As ICG's own witness submitted:

"..... only the timing of the use of allowable tax credits is affected by the utility's present cogeneration proposal; if the cogeneration project were treated as a separate business under the Income Tax Act, these credits would accrue for use against the cogeneration project income in later years."

4.2.4 The Board has already concluded that the cogeneration project should be legally separated from the utility operations of ICG for a variety of valid and precedent reasons as outlined in Chapter 3. If this is not done, then the Board's role of determining the amounts to be excluded from the utility rate base, utility income and the taxes payable must continue in accordance with the provisions of Section 19 of the Act.

4.2.5 The Board concludes that it is clearly ICG's intention that the accounting related to its proposal would, in any financial year, be determined by the Company and not by the Board as is currently required by the provisions of Section 19 of the Act, and as is the case for other gas utilities having non-utility investments which are not legally separated from the utility.

4.2.6 The Board concludes that it would be an unprecedented departure from the principles of regulation to allow ICG to determine the amounts to be excluded from rate base, utility income and the amount of taxes payable by the cogeneration project if it were to remain a division of ICG Ontario. This would also allow ICG, by simple difference, to set the utility rate base, income and applicable taxes. The Board has a specific statutory mandate to operate in the interests of the utility ratepayers and the public in situations identical to that respecting ICG's cogeneration project.

4.2.7 Accordingly, the Board concludes that the Lieutenant Governor in Council should inform ICG that it is required to operate under the jurisdiction of the Board in accordance with Section 19 of the Act. It would, therefore, be the Board under its statutory authority, not

ICG, which would determine, in ICG's next rate case after having reviewed each of ICG's non-utility investments which are not contained in legally separate companies, the appropriate utility rate base, income requirement and applicable taxes.

4.2.8 The Board finds that it does not have sufficient evidence from this hearing to advise the Lieutenant Governor in Council whether the accounting treatment based on principles proposed by ICG would result in just and reasonable rates for ICG's gas customers. However, it is quite clear that without the detailed examination of these principles and their effects by the Board, under the conditions normally encountered in a rate case, there would be a grave risk that inequities would result.

4.2.9 All of the above is unnecessary should ICG establish a legally separate entity as the Board has recommended as a condition of the Lieutenant Governor in Council formally granting ICG's exemption request. The Board's role would, if its recommendation is followed, become one of ensuring adequate equity in ICG Ontario to support its utility operations and ensuring that any intra-corporate transactions between the utility and its cogeneration company were accounted and paid for in a proper manner.

## 4.3 RECOMMENDATION

4. The Board recommends that, in the absence of legal separation of the project from the utility operations of ICG as recommended by the Board in its Recommendation 2(b), the Lieutenant Governor in Council, pursuant to the provisions of Section 19 of the Act, deny ICG's request for special accounting treatment and direct ICG Ontario to continue to operate under the jurisdiction of the Ontario Energy Board with respect to the amounts to be excluded from utility rate base, utility income, and taxes applicable on account of the cogeneration project.

# 5. ICG'S REQUEST FOR A REGULATION UNDER THE ACT

## 5.1 INTRODUCTION

5.1.1 ICG Ontario, in addition to seeking the relaxation of Undertakings 5.4(a) and 5.4(b), and acceptance of the separation and accounting treatment proposed for the cogeneration project, also proposed that a regulation be made by the Lieutenant Governor in Council. The purpose of this regulation would be to confirm the divisional separation of the cogeneration facility for ratemaking purposes, and would also be to ensure that tax savings or tax deferrals attributable to the project would not be used to reduce the utility's customers' rates but would be "streamed" directly to the cogeneration division and indirectly to the benefit of the shareholder.

5.1.2 ICG indicated that it had requested that the accounting treatment be the subject of a regulation, since this would ensure that future Board panels could not change the basis of the benefits related to the accounting and tax treatment thus affecting the economics of, and return to the shareholder from, the project.

5.1.3 The Reference from the Lieutenant Governor in Council did not require the Board to examine this proposed regulation. However, since this became an issue in the hearing, the Board herewith provides the Lieutenant Governor in Council with its advice on the matter.

## 5.2 POSITIONS OF THE PARTIES

### ICG

5.2.1 ICG stated that it requested confirmation that the cogeneration facility be separated from its utility operations for ratemaking purposes and that any tax savings or deferrals attributable to the project not be used by the Board to reduce the utility's customers' rates. This confirmation is being sought by means of a regulation because one panel of the Board cannot bind a subsequent panel. Consequently, a finding in this case confirming the approach

requested by ICG Ontario would not, according to ICG Ontario, give it the assurance that it claims is needed to proceed with the cogeneration project.

5.2.2 ICG Ontario argued that the Lieutenant Governor in Council has the power to make such a regulation under Section 35(1) of the Act, and cited a number of legal cases in support of this proposition including the CRTC vs CTV Television Network et al. [1982] 1 S.C.R. 530.

**Board Staff**

5.2.3 Board Staff submitted that, on the one hand, ICG was saying it did not want the Board to exercise jurisdiction over the cogeneration project but, on the other hand, was willing to have the Lieutenant Governor in Council exercise such control.

5.2.4 Board Staff submitted that the Lieutenant Governor in Council does not, by way of regulation, have the legal power to limit the Board's jurisdiction under Section 19 of the Act. In any event Board Staff submitted that, as a matter of principle, the Lieutenant Governor in Council should be concerned about interfering in an important aspect of the Board's jurisdiction to fix just and reasonable

rates. According to Board Staff, the law of "unintended effect" has the capacity to disrupt the Board in unimaginable and unintended ways if its unique jurisdiction under Section 19 was truncated. Notwithstanding, if such a regulation were enacted, the Lieutenant Governor in Council could, at the request of any person, including the Board, change the regulation.

5.2.5 In support of its position, Counsel to Board Staff submitted a legal argument addressing whether the Lieutenant Governor in Council can pass the requested regulation and whether the authority in Section 35(1)(b) of the Act grants the kind of regulation-making power necessary to accede to the request by ICG Ontario.

5.2.6 A number of cases were cited by Counsel to Board Staff, including Belanger vs the King (1916), 54 S.C.R. 265 (S.C.C.), which, it was contended, demonstrated that regulations such as that requested by ICG had been found to be "ultra vires the Lieutenant Governor in Council"

5.2.7 Counsel to Board Staff submitted that the CRTC vs CTV Television Network et al. [1982] 1 S.C.R. 530 did not support the proposition, as claimed by Counsel to ICG, that the Lieutenant

Governor in Council can pass a regulation which "substantially affects the jurisdiction of the Board".

5.2.8 Counsel to Board Staff submitted that the words "subject to the regulations" at the beginning of Section 19(1) of the Act did not permit the Lieutenant Governor in Council to limit the Board's discretion to fix just and reasonable rates. The Legislature could have passed legislation containing words which would have allowed the regulation to be effective in the manner proposed by ICG, but had not done so.

5.2.9 In the opinion of Counsel to Board Staff the Lieutenant Governor in Council could only pass a regulation approving or fixing rates or other charges and not on a matter as general as excluding assets for rate making purposes. Since the regulation would constitute "inferior legislation", Counsel to Board Staff submitted that it must be read narrowly in the event of conflict between regulation-making power and the Act.

IGUA

5.2.10 IGUA argued that the Lieutenant Governor in Council does not have the power to substantially limit the Board's jurisdiction under Section 19

of the Act through the passage of the proposed regulation.

5.2.11 IGUA submitted that although, under Section 19, the Board "may make orders approving or fixing just and reasonable rates", the Lieutenant Governor in Council may make regulations under Section 35(1)(b) "requiring the Board to approve or fix rates or other charges under Section 19". While the Board may be thus required to fix a rate, IGUA argued that the Lieutenant Governor in Council cannot, by way of regulation, require the Board to fix a rate which, in the Board's judgment, is not just and reasonable. Since the Act requires the Board to fix just and reasonable rates, the Lieutenant Governor has no power, by means of a regulation, to restrict or limit this aspect of the Board's mandate. IGUA cited CRTC v. CTV Television Network et al. as supporting the proposition that where a power to make regulations extends to cover a matter already entrusted to a statutory tribunal, the exercise of such a regulation-making power may substantially affect the jurisdiction of the tribunal.

5.2.12 IGUA argued that even if the Board held the view that the Lieutenant Governor in Council has the power to make such a regulation, the Board should not recommend that the power be

exercised. The Board's power to remedy any inequity falling upon the ratepayers should not be restricted. IGUA further submitted that the Board should retain its power to set just and reasonable rates.

NSI

5.2.13 NSI submitted that a regulation as proposed by ICG would amount to an amendment to the Board's legislation since it would materially change the Board's jurisdiction. NSI expressed concern that a regulation could be used in a manner which, it suggested, would throw into doubt the stability and consistency of regulation in Ontario. Due to the significant differences between the process involved to amend legislation and that required to approve regulations by the Lieutenant Governor in Council, NSI questioned whether the regulation requested would bring much comfort to ICG. It suggested that even if such a regulation were issued, it could be rescinded on request if circumstances change in the future.

5.2.14 In NSI's view, any assurance to ICG, or others, against future actions should be through amended legislation. However, NSI submitted that there is reason to believe that the project is viable on a stand alone basis; consequently, neither

amendment of the legislation for plant ownership purposes, nor a regulation as proposed, should be recommended by the Board. NSI referred to ICG's argument in which it stated that if it were not permitted to own and operate the project "it would require contract negotiations to ensure that the cogeneration project would continue with a different owner" and concluded that ICG recognizes that alternate ownership is possible.

**Union**

5.2.15 Union submitted that any regulation promulgated as a result of the hearing should relate only to the ICG "utility family" and should not be generally applied to other Ontario natural gas utilities. It argued that to do so would be a denial of natural justice to those utilities, since the hearing was specific to ICG and not generic in nature.

**ICG Reply Argument**

5.2.16 On the matter of the jurisdiction of the Lieutenant Governor in Council, ICG stated that both Board Staff and IGUA were wrong. It argued that the Lieutenant Governor in Council has the jurisdiction under paragraph 35(1) (b) of the Act to make the regulations proposed by ICG.

In support of its position, ICG submitted that:

- the cases cited by Board Staff merely stand for the proposition that a regulation may not override the express requirements of the statute under which it is made. Providing reasons, ICG submitted that its position is that the regulation proposed by ICG would not override the express requirements or language of the Act; and

- the passage from the decision of the Federal Court of Appeal cited by the late Chief Justice Laskin in CRTC vs CTV Television Network et al., [1982] 1 S.C.R. 530, at p. 544-545, though not deciding the matter, certainly indicates that the Courts are prepared to entertain the argument that, where a power to make regulations covers a subject matter already entrusted to a statutory tribunal, the exercise of such regulation-making power may substantially affect the jurisdiction of that tribunal.

## 5.3 BOARD FINDINGS

5.3.1 The Board holds the view that while maximizing a shareholder's return, at the expense of

Revenue Canada may be a legitimate corporate strategy for a private corporation not subject to regulation, there is reason to question, as several intervenors did, whether the special accounting treatment requested by ICG as a regulated utility company is totally fair to the utility ratepayers. Most importantly, in the Board's view, the regulation sought by ICG Ontario to achieve this special status, to the shareholder's benefit, would seriously restrict the Board's future mandate to examine this important issue under the provisions of Section 19 of the Act.

5.3.2 The Board is currently required by Section 19 of the Act to fix just and reasonable rates through the review of the utility operations of ICG Ontario in the context of that company's overall activities, and having done so to find an appropriate utility rate base, revenue requirement, including the fair cost of capital, and an appropriate allowance for income taxes when it fixes utility rates. Accordingly, such a regulation, even if not ultra vires as was submitted by several intervenors, could, by limiting the scope of the Board's review, seriously affect the Board's ability to fix rates that are 'just and reasonable'.

5.3.3 It appears to the Board that the reason the Lieutenant Governor in Council is being asked to enact such a regulation and restrict the Board's powers is solely so that the equity shareholder of ICG may obtain a higher return on invested equity due to the $7.14 million benefit from the time value of the tax deferrals. The divisional separation and accounting treatment is purely tax-driven, and the requested regulation is designed to guarantee that all of the time value benefit flows to the cogeneration project and hence to the equity investor in that non-regulated activity.

5.3.4 In the Board's view, however, the impact on the utility of the proposed structuring and flow-through of tax benefits will require close scrutiny by the Board in future rate cases unless a separate legal cogeneration entity is established. The proposed regulation, which attempts to restrict the Board's authority to carry its statutory regulatory mandate, would be an unfortunate precedent which would not be in the public interest and would have major ramifications for other utilities.

5.3.5 In the Board's view, Section 35(1)(b) of the Act does not empower the Lieutenant Governor in Council to fix rates himself, which he would have to do in order to require the Ontario

Energy Board to approve or fix rates in the manner proposed by ICG. Section 35(1)(b) is a procedural mechanism only, by which the Lieutenant Governor in Council can require the Ontario Energy Board to exercise its jurisdiction under Section 19 of the Act.

5.3.6 **The Board concludes that the Lieutenant Governor in Council does not have the jurisdiction under Section 35(1)(b) of the Ontario Energy Board Act to make the regulation requested by ICG Utilities (Ontario) Ltd and that, in any event, such a regulation would not be in the public interest.**

## 5.4 RECOMMENDATION

5. **The Board recommends that the Lieutenant Governor in Council deny ICG's request for a regulation separating the assets and income of the cogeneration project from those of the regulated utility for the purposes of Section 19 of the Ontario Energy Board Act.**

# 6. COSTS AND COMPLETION OF THE PROCEEDINGS

## 6.1 COSTS

6.1.1 Section 28 of the Act empowers the Board to award costs and the Board's June 12, 1985 E.B.O. 116 Report sets out considerations by which the Board will be guided as a general rule in the exercise of its discretion to award costs to intervenors. Awards may be made to an intervenor who:

(a) has or represents a substantial interest in the proceeding to the extent that the intervenor, or those it represents, will be affected beneficially or adversely by the outcome;

(b) participates responsibly in the proceeding; and

(c) contributes to a better understanding of the issues by the Board.

6.1.2 The following parties requested costs in the proceeding:

6.1.3 AMO submitted that the Association should be awarded its costs in this proceeding.

6.1.4 IGUA submitted that it had participated in this proceeding in the same manner it has participated in rate cases before the Board where the Board has seen fit to award IGUA 70 percent of its reasonably incurred costs. IGUA accordingly submitted that it should be awarded 70 percent of its reasonably incurred costs.

6.1.5 NSI submitted that, through its argument, it had contributed to the Board's understanding of the issues and that its intervention was conducted in a cost effective manner. It hoped that an understanding of the concerns of NSI, and its suggestions as to alternatives that are available would prove helpful to the Board in its deliberations. Accordingly, NSI requested that it be awarded its full costs of participation in the hearing.

6.1.6 Indeck submitted that as a developer of cogeneration projects in the ICG franchise area it is a customer of ICG and had a substantial interest in the proceeding. It submitted that it had participated responsibly, and through its evidence it had assisted the Board in trying to put a value on the benefits to ICG Cogeneration Division, and in understanding in general, this rather complex issue. Indeck accordingly requested it be paid 100 percent of its costs in the proceeding.

## 6.2 BOARD FINDINGS

6.2.1 The criteria established in EBO 116 primarily address the matter of an intervenor's eligibility for a cost award. Considerations of the amount of any such award is a matter for the individual Board panel hearing the case to decide, based on the nature of the intervention by parties to Board proceedings, how this furthered the public interest and a complete examination and understanding of the issues by the Board.

6.2.2 The Board has carefully considered the participation by parties requesting an award of costs, and has also considered the argument submitted by these parties.

6.2.3 AMO originally applied for funding under the Intervenor Funding Project Act ("IFPA") and, after a hearing, subsequently withdrew that application. This application resulted in needless costs for the Board and ICG which, however, cannot be accurately assessed. Since the IFPA proceeding is considered by the Board to be part of the overall EBRLG 33 proceeding, the Board has taken into account the circumstances of the IFPA hearing in its award of costs to AMO.

6.2.4 AMO was unable to participate in the hearing due to its Counsel's illness, and the argument submitted was necessarily brief.

6.2.5 **Accordingly, the Board finds that AMO is entitled to 50 percent of its reasonably incurred costs excluding its costs related to the IFPA hearing.**

6.2.6 IGUA participated responsibly in the proceeding although its intervention was quite narrowly based. The argument submitted by IGUA was found to be relevant and helpful to the Board. Accordingly, the Board finds that IGUA is entitled to 70 percent of its reasonably incurred costs, as requested.

6.2.7 NSI did not actively participate in the hearing; however, the argument submitted was of high quality and informative and helpful to the Board in its consideration of the issues.

6.2.8 **Accordingly, the Board finds that NSI should be awarded 70 percent of its reasonably incurred costs.**

6.2.9 Indeck participated responsibly in the hearing, although certain parts of its evidence departed from the primary issues before the Board and its most direct experience was in the United States.

6.2.10 Indeck's argument was comprehensive and covered the main issues in a way which was informative to the Board.

6.2.11 **Accordingly, the Board finds that Indeck should receive 60 percent of its reasonably incurred costs of participating in the proceeding.**

6.2.12 **The Board finds that the foregoing costs awarded to the parties named shall be borne by ICG Ontario.**

6.2.13 **The Board finds that the Board's costs shall be paid by ICG Ontario and shall be payable on receipt of the Board's billing.**

6.2.14 The parties eligible to receive costs in accordance with the Board's Findings, are hereby directed to submit their claims for such costs within 15 working days of the release of the Board's Report to the Lieutenant Governor in Council.

## 6.3 COMPLETION OF THE PROCEEDINGS

The Board herewith submits its Report and Recommendations to the Lieutenant Governor in Council, in accordance with the requirements of the Reference under Order-in-Council 1499/89 dated June 12, 1989.

APPENDIX A

## SUMMARY OF THE POSITIONS OF THE PARTIES TO THE HEARING

The parties to the hearing made submissions with respect to the issues in the case and the question of whether the Board should recommend that the exemption to Articles 5.4 of the 1988 Undertakings be granted to ICG. The Board has summarized these submissions but, in doing so has found that there is no common perspective of the issues related to the exemption request and hence, there is some degree of overlap and duplication in the positions presented on these issues.

### ICG ONTARIO

#### Policy Considerations

ICG noted that the Board supported cogeneration in its H.R. 16 Report and, that it encouraged ICG Ontario to penetrate the cogeneration market in its Reasons for Decision in E.B.R.O. 430. ICG Ontario also indicated its belief that the Ontario Government, as a matter of policy, strongly supports the development of a cogeneration industry in Ontario.

ICG Ontario acknowledged that the objective expressed in the 1988 Undertakings is that the utility should not be involved in non-utility investments. It submitted that there should, however, be flexibility in the application of this objective. It is submitted that there is a strong case for an exemption to the general objective where the activity is energy-related and results in an increased usage of natural gas, where the risk to the utility operations is minimal and where there are benefits to the utility operations and the broader public.

ICG Ontario acknowledged that an approval for its investment in the Boise cogeneration project should not be a precedent for approval for any future investments cogeneration projects. The Cogeneration Division has additional projects under consideration but it intends to negotiate these on a basis which will allow a reasonable return on investment outside of ICG Ontario.

**Project Economics**

ICG submitted that the economics of the project are important for assessing the risk to the utility operations of ICG Ontario and for determining whether an adequate return on equity will be earned by Inter-City which is investing the equity in the project.

ICG Ontario submitted that the economics of the cogeneration project, if structured as proposed, are attractive. It argued that, in addition to the favourable returns which will tend to strengthen ICG Ontario financially, there will be surplus funds as a result of the inability of Inter-City to take surplus cash out of ICG Ontario and this will strengthen the balance sheet of ICG Ontario.

ICG noted that the actual base case return to Inter-City on its equity investment in the cogeneration project is 20.47 percent. Its expert witness, Mr. Falconer, termed this return appropriate given the financial and business risks of the project.

ICG noted the evidence of Mr. Anderson, who testified on behalf of Northland Power, that it should have been assumed that the surplus funds would be reinvested at the return earned by the project (approximately 20 percent after tax) as opposed to a short-term investment rate of 12 percent. ICG submitted that in making this assumption, Mr. Anderson apparently was unaware of the undertaking by ICG Ontario not to invest in unregulated activities without the leave of the LGIC. ICG argued that to the extent that the return to Inter-City is a relevant consideration for the Board, the view of its expert witness should be accepted because it is a conservative approach which Inter-City has adopted in considering its investment in the project.

ICG submitted that the Board should not recommend to the Lieutenant Governor in Council any condition which would have an adverse impact on the economics of the cogeneration project; in particular, should not recommend an undertaking to "roll-out" the cogeneration investment prior to 15 years due to the potential tax and legal complications associated with such a transaction.

Risk to Utility and Ratepayers

ICG Ontario submitted that the most critical consideration which the Board must review is the risk to the utility operations of ICG Ontario from an investment in the cogeneration facility. It submitted that the Board needs to be satisfied that the risk is minimal. In ICG's view, in addition to an examination of the project economics, an assessment of the risk to the utility operations involves the nature of the contract provisions and the project technology.

Contracts

ICG submitted that the terms of the contracts which it has negotiated with Boise Canada, Ontario Hydro, Fluor Daniel Canada Inc. ("Fluor Canada"), and its two gas suppliers minimize the risks associated with the construction, start-up and operation of the

cogeneration project. The primary risks that ICG Ontario claimed it has mitigated through its contracts are:

i) the risk of cost overruns and delays in the completion of construction;

ii) the risk of significant changes in the relationship between sales revenues and input costs over the term of the project;

iii) the risk that actual sales volumes will not match projected sales volumes; and

iv) the risk that the project's supply of natural gas will not be maintained throughout the term of the project.

With respect to the risks associated with the project technology, ICG Ontario submitted that the risks are negligible because cogeneration technology is well estabished in the USA and that both Fluor Canada and its parent had considerable expertise in the construction and start-up of similar facilities.

BOARD STAFF

**Policy Considerations**

Counsel to Board Staff noted the Government's active encouragement of a strong cogeneration industry in Ontario. However, it submitted that, while it fully supports the development of cogeneration, this should not happen at the utility ratepayer's expense.

**Project Economics**

Board Staff submitted that an essential step in analyzing the Company's request for an exemption to the Undertakings was whether the cogeneration project can be economically built outside ICG Ontario.

Board Staff submitted that if this could be done, the Board should recommend that the Lieutenant Governor in Council not allow the project to be inside ICG Ontario.

Board Staff submitted that, due to the lack of detailed numbers and because of ICG's failure to file complete contracts, it was impossible to adequately assess ICG's assumptions underlying its economic analysis of the base case and alternative cases. Therefore, it was impossible to conclude whether ICG's analysis was correct.

In addition, Board Staff contended that ICG had been conservative in forecasting its revenues and pessimistic in forecasting operating costs, particularly gas costs for which the maximum cost increases were assumed in the contract reopener years.

Board Staff submitted that since ICG had not provided full details to support its economic analysis, the Board should use caution in determining the weight it gives to ICG Ontario's forecasts.

Board Staff noted that ICG's assertion that the project would be uneconomic, if structured in any way other than that proposed, was based on two criteria; the calculation of an IRR which was then compared to the project's weighted average cost of capital ("WACC"); and the return ("ROE") to the investor. It also noted the differing opinions of ICG's and Northland's expert witnesses about the methodology and significance of the ROE calculation.

Board Staff supported the position of Northland's witness that the stand-alone ROE estimates should be 17.29 percent compared with 20.47 percent in the base case. It questioned whether ICG had shown this to be unacceptable since it had declined to state what the "lowest acceptable" ROE would be.

Board Staff argued that, in any event, the ROE of the equity investor should be of minor relevance to the Board in making its recommendation and only material to the question of whether the project may or may not proceed. It also contended that ICG's assumptions about debt equity ratios affected the WAAC and noted that in the stand-alone case there would be no need to maintain a debt to equity ratio similar to that set for the utility.

Board Staff submitted that there is a strong indication the project could proceed on a stand alone basis. It therefore argued no exemption be recommended. Board Staff also suggested that a roll-out of the Project once the CCA benefits were realized could be a second best alternative to a stand-alone project. It noted the potential difficulties with Revenue Canada, the complicated nature of such a transaction and the effect on the ROE alluded to by ICG, but submitted that these considerations such be given less weight than the reduced risks to the utility which would result.

Board Staff submitted that if ICG proceeded as proposed the benefit to the utility ratepayers was inadequate to compensate for the increased risk. Compensation, it submitted, should be related to the $7.145 million NPV benefit of the tax deferrals generated by applying the project's accelerated CCA against utility income. It submitted that a fee, or

rent, of 50 percent of this would be appropriate. It noted that $7.145 million was equivalent to an annuity of about $3.727 million for 4 years and submitted that compensation should therefore be set at approximately $1.85 million per year for 4 years.

Board Staff argued that the Board ought not be persuaded by ICG's argument that this would lower the ROE to an unacceptable level since, in its view, it was only just and reasonable that the cogeneration project pay for the use of the ratepayers' asset. Board Staff concluded that the project economics were such that it did not represent an unacceptable risk to the integrity of the utility, even if undertaken within ICG Ontario.

**Contracts**

Board Staff submitted that analysis of the contractual risks had been hampered by ICG's unwillingness to file the complete contracts. It submitted that not all the foreseeable risk were covered. It listed some of these risks, including construction cost overruns, increases in gas prices and other operating expenses, lack of guarantees by Boise Canada's parent and no provision for liquidated damages if Hydro does not take all the power. In addition, it submitted that there were bound to be unforeseen risk associated with the project.

Board Staff concluded, therefore, that some risk remains to the utility if the project is in ICG Ontario.

**Risks to the Utility and its Ratepayers**

Having analyzed the direct risks due to project economics, contractual arrangements and project technology, Board Staff also considered other financial risks to the utility if the project was structured as part of ICG Ontario. The focus of Board Staff's submission in this regard was the matter of the credit rating of ICG Ontario, which, it submitted, was of vital importance to the Company and to utility rates.

Board Staff noted that, although the risk of the project is somewhat greater than for the utility, the credit rating was unchanged in the latest review with the rating agencies. However, since ICG's credit rating is on the edge of what is considered to be always financable, Board Staff submitted that ICG's credit rating could be impacted negatively if the projects actual results were only marginally worse than those contained in the forecasts presented to the Board and to the rating agencies.

Finally, Board Staff submitted that since ICG Ontario is seeking an exemption to the general and preferred policy of maintaining a pure utility as provided in

Articles 5.4(a) and (b) the Board should analyze whether:

- the project can be economically built outside the utility;
- ICG has shown that the project will not go ahead if approval is not granted;
- the risks and benefits to the utility ratepayers are acceptable; and
- after the above have been considered and the decision is in the balance, there are benefits to the other participants and to the general public.

Board Staff submitted that ICG has not met the required onus since:

- the project can be economically built outside the utility;
- on a risk/benefit analysis ICG's proposal does not meet the criteria sufficiently to be granted an exemption to Undertaking 5.4; and
- while the general benefits are apparent, the Applicant has failed to meet the onus on it in respect of the first three criteria above.

In the event, however, that the Board should decide to favour an exemption to the Undertakings, Board Staff submitted that it recommend the following for consideration of the Lieutenant Governor in Council:

- rolling out the project as soon as possible;
- making the cogeneration project pay an economic rent for the use of the utility income and stream;
- ordering ICG to keep effective records to allow assessment of any cross- subsidization; and
- reporting to the Board's ERO and in every rate case on the financial performance of the project.

IGUA

**Structure of the Cogeneration Project**

IGUA argued that the driving force for placing the Cogeneration Project in ICG Ontario was to make an attractive return for the shareholder. It argued that the investment risk of the shareholder is reduced by the investment being made in the utility corporation while that of the ratepayer is increased. IGUA noted that although ICG Ontario claimed this additional risk to be minimal, no compensation was to be paid for the utility bearing this risk.

IGUA considered that the main question to be answered is whether the regulated utility should be used to permit shareholders to achieve higher returns than would be available if the investment in cogeneration facilities as a non-utility activity were made outside the utility. IGUA stated that the answer to this question affects not only this project but others that may be developed by ICG Ontario and other Ontario regulated utilities. IGUA stated that it has consistently taken the view that such non-utility investments should be made outside the utilities; however, if the Board approved such investments by the utility, any risk to the utility's ratepayers should be eliminated entirely.

**Risk to the Utility and Ratepayers**

IGUA also argued that the Board was unable to properly assess the project economics and the risks because of ICG's unwillingness to produce the contracts. Therefore, in IGUA's view, there is a failure by ICG Ontario to prove its case.

IGUA argued that investment in the Cogeneration Project within the utility results in increased risk to the utility because the cogeneration business is riskier than that of a utility, and that this is indicated by the required rate of return on common equity of 20.47 percent after tax. IGUA also pointed out that Mr. Didur had agreed in the hearing that cogeneration is riskier than the utility business.

IGUA submitted that, as a result of this increased risk, the ability of ICG Ontario to raise money at reasonable rates may be impacted, leading to the possibility of higher rates for ratepayers. IGUA argued that the ratepayer should not face this risk to enable the shareholders to achieve a higher return on their investment. Therefore, IGUA argued, the investment should not be made within the utility operation.

IGUA argued that, because the "roll-out" alternative is unavailable, the Board can only accept or reject ICG Ontario's proposal. IGUA submitted that the Board should reject it.

If, however, the Board determined that the investment in the project should be within the utility, IGUA argued that the shareholders should bear all the risks. Moreover, the undertaking of Mr. Didur that the utility's ratepayers would be saved harmless if the investment was made within the utility, should be formalized.

**Benefits to the Ratepayers**

IGUA noted the financial benefits indicated by ICG Ontario as accruing to the ratepayers if the cogeneration investment is made within the utility but argued that these benefits would still be enjoyed by the ratepayers if the investment were made outside the utility operation.

**Shareholder Considerations**

IGUA submitted that by making the investment through the utility, the shareholder's return is increased at no extra cost to it. IGUA disagreed with ICG Ontario's view that the Cogeneration Division should not pay for this benefit. IGUA submitted that ICG Ontario had assumed that the whole of the $7.145 million benefit should be paid to the investor, whereas in IGUA's view this benefit should be shared between the shareholders and the ratepayers. IGUA calculated that, on this basis, the investor's return would be 18.68 percent after tax.

IGUA submitted that the ratepayer is providing an asset, namely the utility income stream, which should be paid for by the shareholder.

**Impact on the 1988 Undertakings**

IGUA pointed out that approval of the proposal would set back the desired move towards a pure utility operation. IGUA argued that the wish of the shareholders to utilize the utility corporation for their benefit to make a non-utility investment is insufficient reason to approve a business proposition which violates the 1988 Undertakings. Furthermore, the shareholders of ICG Ontario should not, in IGUA's submission, be placed in a preferred position compared to other parties interested in cogeneration investment.

**Conclusions and Recommendations**

IGUA submitted that the Board should find and report to the Lieutenant Governor in Council that:

(a) the primary purpose of placing the Cogeneration Project in the utility was to make an otherwise economically unattractive investment an economically attractive investment for the equity investors;

(b) the Cogeneration Project in the utility provides no greater benefit to the utility ratepayer than a similar project structured outside of the utility;

(c) the equity investors in the cogeneration project obtain a financial benefit of approximately $7M through the use of the utility income stream;

(d) the ratepayers face the potential of adverse financial consequences with the inclusion of the Cogeneration Project in utility operations;

(e) the proposal contemplates no payment to the ratepayers for the risks incurred by them or for the use of the income stream provided by the ratepayers, which the shareholders require to make their economically unattractive investment opportunity an economically attractive opportunity; and

(f) the proposal clearly requires a move away from the desired goal of a pure utility.

IGUA further submitted that the Board should recommend to the Lieutenant Governor in Council:

(a) That the LGIC not grant ICG Ontario an exemption;

(b) In the alternative, if the LGIC grants an exemption that the following conditions be applied:

(i) ICG Ontario will undertake to indemnify and save harmless the ratepayers from any adverse financial consequences to the ratepayers arising out of the inclusion of the Cogeneration Project in utility operations;

(ii) ICG Ontario will provide to the Board and interested intervenors financial information with respect to the Cogeneration Division in a form satisfactory to the Board, which will enable informed decisions to be made on whether inclusion of the Cogeneration Division adversely impacts the position of the ratepayers; and

(iii) the benefit of $7.4M to the shareholder resulting from the use of the utility income stream will be shared equally between the shareholders and the ratepayers.

INDECK

**Introduction**

Indeck commented on the timing of ICG Ontario's application noting that ICG Ontario had provided no convincing argument why it had proceeded with the project prior to obtaining leave.

Indeck commented that ICG Ontario's conduct has put unfair pressure on the Board to find in ICG's favour. This is because it is being asked to give advice to the Government with respect to a project already 25 percent completed and for which the Premier and senior Ministers of Ontario had been invited to attend ground-breaking ceremonies earlier in 1989. In Indeck's opinion, the timing of ICG Ontario's request in respect to the 1988 Undertakings makes a travesty of the regulatory process.

**Risk to the Utility**

Indeck argued the project has received a benefit through taking immediate advantage of Class 34

accelerated depreciation against revenue generated by the utility. The Cogeneration Division has paid nothing for this cash infusion which has been largely created by ratepayers.

In calculating the value of this benefit, Indeck submitted that a higher discount rate than that used by ICG should be used. It submitted that 13.5 percent is ICG's allowed return on utility common equity, would be a possible figure because the cash provided by the utility is common equity rather than debt. On this basis, the value of the accelerated tax savings is substantially higher than $9 million, according to Indeck.

However, since the cogeneration project is riskier than the utility business. Indeck submitted that the utility should be entitled to earn a return greater than 13.5 percent on the cash provided to the cogeneration project. It proposed a return in the 16-19 percent range and specified a minimum of 17 percent over the term of the project.

**Benefit to the Utility Ratepayers**

Indeck contended that the utility's income and its status as a gas distributor, allow ICG to fit within the definition of a principal energy business for the purpose of the Class 34 accelerated write-offs to be used for financing the Cogeneration Project. Indeck

submitted that if the Board allows the project within the utility, it should ensure that the ratepayers receive a fair return on their contribution.

Indeck also asserted that the Cogeneration Division has already derived benefits from the regulated utility by using its credit to raise $25 million in short-term bank financing for the project and to obtain the Hydro loan at 4 percent.

The benefits of the short-term financing and the Hydro loan can be estimated, according to Indeck, by calculating the present value of the difference between the market rate of return on equity and the interest rate paid by ICG for its short-term loan, multiplied by the amount of the funds borrowed and spent prior to obtaining final regulatory approval.

**Shareholder Considerations**

Indeck argued that it is "simply not credible" that, having already spent $25 million on the project, ICG Ontario would not proceed if approval was not granted. It pointed out that Northland had shown, in evidence, that Inter-City's investment of $18.2 million yielded 33.5 percent (inside the utility) or 17.29 percent (outside the utility) both after tax. Indeck referred to Northland's further indication that the return, on a stand-alone basis, could be even higher if ICG planned to pay off the bank over a 15 year, rather than an 8 year, period.

Indeck criticized ICG Ontario's assumption that excess cash thrown off by the project in its early years would be invested at 12 percent. It pointed out that at least one other project has been discussed at the National Energy Board (a proposed plant at Sault Ste. Marie), thus it was highly probable that ICG Ontario would invest funds generated by the first Cogeneration Project in similar projects earning a similar rate of return and not at 12 percent. Indeck termed as "commercially incredulous" the notion the ICG Ontario would use cash from the first cogeneration project to repay project loans.

Indeck submitted, in argument, its own calculations supporting its contention that the return is 40.33 percent if the project is inside the utility as proposed by ICG, 25.71 percent if outside the utility, and 28.56 percent if inside the utility with a notional 20 percent "fee" being paid to the ratepayers.

**Conclusions and Recommendations**

Indeck submitted that the Board should not grant the orders requested by ICG, and that the project should proceed outside the utility.

Indeck submitted that if ICG Ontario decided not to carry on with the Cogeneration Project, in the event of an adverse response by the Board, there would be "many developers" prepared to carry on the project

which, in Indeck's view, could be sold as developed to date at a profit.

Indeck stated that it would be bad public policy for the Board to accede to ICG's request, firstly because it would create a precedent for ICG and others for a practice that provides a "super return" to shareholders at the expense of ratepayers and secondly, because the division would assist anti-competitive practices in the cogeneration industry leading ultimately to a slowdown in its development in Ontario.

Indeck submitted that the issue in this case is whether the Cogeneration Project should be placed inside or outside the utility. In opting for the latter, Indeck argued that this would be fairer to ratepayers, more efficient in terms of regulation, consistent with regulatory practice and more likely to avoid conflicts of interest and self-dealing.

NORTHLAND

**Policy Considerations**

Northland submitted that the Board should not grant an exception to ICG. Northland submitted that this will protect utility ratepayers from regulated utilities entering into unregulated business ventures. Northland submitted that approval will set a precedent

encouraging utilities to engage in further business transactions designed to avoid rate base examinations while simultaneously reaping the benefits of secure and regulated monopolies. This, it argued, would erode the public utility concept of regulation. It argued that such comingling of regulated and unregulated business will make it more difficult for the Board to carry out its role.

**Project Economics**

Northland criticized ICG's calculations of the shareholder benefits. In Northland's submission, these figures are a gross understatement of ICG's total benefits. Northland provided additional data showing the effect of changing ICG's assumptions on the benefit to the shareholder.

**Benefits to Utility Ratepayers**

Northland noted all the benefits flow to the Cogeneration Division and the shareholder and stated its objection to "this abuse of the ratepayers for a tax-driven transaction designed to benefit others".

Northland submitted that the "benefit" to the ratepayers of $742,000 will be realized regardless of whether or not the project was held in or out of the utility. It argued that, therefore, the $742,000 contribution is not a benefit which can be viewed as a

contribution to the ratepayers or compensation for the increased risks of the Cogeneration Project.

**Conclusions and Recommendations**

Northland submitted that the project should not be within the utility. It argued that if approval is granted, ICG should pay a fee to the utility and the Board should supervise ICG to ensure that it develops the project and makes use of revenues in the same manner as presented in ICG's application.

Northland concluded that it is not in the public interest to subject the ratepayers to risks without a compensating benefit.

NORTH SHORE INDUSTRIES

**Project Economics**

In NSI's opinion the stand-alone option should have been examined in greater detail with a view to optimization of this alternative. In NSI's view, the evidence is therefore deficient and of limited use.

For example, NSI pointed out that regardless of ownership of the project, and given a Class 34 ruling and an adequate taxable income stream, the return results will be similar to those forecast by ICG. In addition, ICG could have explored other means to

optimize its return on a stand alone basis by methods such as a prepayment by Hydro against power deliveries.

Finally, NSI suggested that the accuracy of ICG's estimates may be suspect since this is the first installation of this size and type that it has undertaken.

**Risks to Utility Ratepayers**

NSI submitted that while ICG Ontario claimed that the business risks of the Cogeneration Project have been minimized, the central issue is the regulatory risks and who should bear them. NSI argued that if, for example, the Boise plant were to close, it is uncertain what accounting treatment will be used to deal with any resulting losses.

NSI submitted that any policies promulgated by the LGIC as a result of the Board's report would without legislation, not provide any certainty as to actions that may be taken in the event the project becomes uneconomic in the future. NSI submitted that a Board Panel cannot bind a subsequent Board Panel. NSI argued that this risk requires the Board to recommend an exemption only if the Board can provide assurance to ICG Ontario's utility customers that their rates will never be impacted by the cogeneration plant. Since the Board will be unable to give such an assurance, NSI submitted that the Board will not be able to recommend exemption.

**Benefits to Ratepayers**

NSI submitted that the benefits claimed by ICG for the ratepayers will accrue to them regardless of ownership of the facility. NSI submitted that since ownership is irrelevant to such benefits, it should not be used to persuade the Board to recommend relaxation of the undertaking.

**Shareholder Considerations**

NSI argued that the benefits to shareholders far outweigh those to ratepayers.

**Conclusion and Recommendations**

NSI stated that there had been no change in circumstances which would cause the Ontario Government or the Board to now consider the 1988 Undertakings unnecessary. NSI argued, therefore, that the Board should only recommend to the LGIC that ICG be permitted to implement its proposal if the Board is satisfied that ICG will continue to provide the same protection through some other means throughout the project's life. NSI contended that the evidence does not give any such assurance. Since it does not appear possible for the Board to be satisfied on these points, NSI contended that the Board must recommend to the LGIC that ICG should not be exempted from the obligations of Article 5.4.

TCPL

**Policy Considerations**

TCPL stated that in general terms it was supportive of the development of cogeneration projects in Ontario. TCPL submitted it would be wrong to unequivocally bar utilities from participation in cogeneration simply because it is an unregulated activity.

**Project Economics**

TCPL did not comment on what is the correct view of the internal rate of return for the project inside or outside of ICG Ontario. TCPL submitted that the key factor is that the rate of return is significantly higher if the Class 34 write-off is utilized in ICG Ontario to take advantage of the income stream. TCPL submitted that the Class 34 CCA allowances were established as an incentive by the Government to encourage the efficient use of energy in Canada. If the project offers significant benefits, and risks to ratepayers are minimized, it does not make sense to force the project to be carried out in a fashion which would lower the expected return. Therefore TCPL argued that ICG should be permitted to take advantage of the ICG Ontario income stream.

**Risks and Benefits to Utility Ratepayers**

TCPL submitted that there are benefits to the utility and its ratepayers from the project. It further submitted that if the utility income stream is not being used for any other purpose, and if there was no cost or increased risk to the utility, then any suggestion about compensation for the use of the income stream in the form of economic rent was not appropriate. In any event, TCPL submitted there was no evidence on which to make a realistic quantification of such an amount of compensation or economic rent.

TCPL submitted that on the issue of risk to the utility, the evidence of Mr. Falconer should be given considerable weight. This evidence was that the credit rating of ICG Ontario would not be adversely affected and the financial risk to the utility should not be of concern. Also, Mr. Falconer stated that the business risks and technology risks had been minimized.

UNION

**Policy Considerations**

Union stated that it generally supported the development of cogeneration using natural gas, as being in the public interest. It stated that natural

gas utilities are the logical parties to implement public policy on cogeneration using natural gas.

**Risk to the Utility and its Ratepayers**

Union submitted that ICG's evidence of minimum risk was unshaken in the hearing. Union noted the steps ICG has taken through its contracts to mitigate risk and argued that these measures appear prudent and therefore the Board should conclude that the risk to the utility is slight.

Union submitted that the ratepayers currently have no current use for the utility income stream and that they will in effect be receiving an annual "windfall" of $742,482 as a result of ICG's proposal. It argued that the ratepayers are, at worst, indifferent, or at best receiving benefits otherwise not available to them.

**Shareholder Considerations**

Union submitted that there is an appropriate balancing of risks and benefits to the shareholder in ICG's proposal and that the shareholder benefit was not at the expense of additional risk to the ratepayer.

Union noted that the prime purpose of the undertakings is to protect the financial integrity of the utility

and thereby shield the ratepayers from undue risk. In Union's view ICG's proposal presents minimal risk to the ratepayers and is in accordance with government policy. Therefore ICG should be granted the exemption.

Union noted that, in supporting ICG, it was of the opinion that the decision of the Lieutenant Governor in Council was specific to ICG. In Union's view other gas utility undertakings and their businesses are distinct from those of ICG.

ICG REPLY ARGUMENT

ICG Ontario submitted that neither Board Staff nor the intervenors had advanced any convincing argument why ICG Ontario should be prevented from proceeding with the Cogeneration Project as planned. In ICG's view, the advantages of permitting ICG Ontario to own and operate the Cogeneration Project clearly outweigh any perceived disadvantages. ICG maintained that if the Board is satisfied that the risks to utility operations are minimal then the Board should recommend approval.

ICG Ontario also submitted that there can be a proper separation within ICG Ontario of the utility operations and the Cogeneration Project in a manner which will allow the Board to properly regulate the utility activities of ICG Ontario.

ICG's position is that the Board and the LGIC should be concerned that the shareholder, who is investing in the Cogeneration Project, receive an adequate return and that this is an integral part of the risk assessment. In ICG's view the ratepayers and shareholder of ICG Ontario have a common interest that ICG Ontario's utility operations not be prejudiced by the Cogeneration Project.

ICG Ontario submitted that, contrary to Board Staff's position, it does not have any onus to demonstrate to the Board that the Cogeneration Project would not be built at all unless dispensation is granted. The Company contended that this is not directly relevant to the Board's consideration of whether it is appropriate or fair to allow the Cogeneration Project in ICG Ontario.

With respect to Board Staff's concern that the determination of this matter on its own merits may be unfair to other utilities, ICG Ontario submitted that the Board should consider its recommendation with respect to this particular project on the project's merits. It should also make it clear that future projects will have to be assessed on a case by case basis.

ICG Ontario acknowledged that the Board should give considerable weight to broad policy concerns, namely

the development of cogeneration in the Province. The ability of ICG Ontario to take advantage of the accelerated Class 34 capital cost allowance, which has been provided by the Federal Government for the purpose of encouraging energy projects such as the Cogeneration Project, should also be a factor in the Board's recommendation. ICG Ontario asserted that the development of the Cogeneration Project in ICG Ontario will not be at the expense of the ratepayers of ICG Ontario because in its view the risks are minimal.

With respect to the criticism of ICG Ontario having proceeded with the project before obtaining approval, ICG noted logistical problems and submitted that it never intended to have the project so far advanced before the hearing. Nevertheless, ICG and Inter-City have assumed the risk that the project may not be approved in which case the ratepayers cannot suffer. ICG also recommended that in assessing the arguments of Northland and Indeck, the Board should bear in mind that those parties are direct competitors of ICG Ontario in the cogeneration field and have a commercial interest in limiting ICG Ontario's involvement in the industry.

In addressing the specific project economics ICG submitted that, contrary to the submissions made by IGUA and Board Staff, no party was disadvantaged in the cross-examinations by not having the actual

contracts. The financial information which was produced was sufficient to enable the parties to conclude that the risks to the utility were minimal. The Company also asserted that all of the assumptions which went into the economic forecasts were available for examination at the hearing and that those forecasts were prepared on a basis which was in accordance with the expected project performance.

ICG Ontario also submitted that none of the risks identified by Board Staff should be considered serious and that, in any event, those risks are mitigated by the very contractual arrangements reviewed in Board Staff's argument.

ICG argued that the question for the Board is whether ICG Ontario has, through its contractual arrangements, reduced the risks associated with the Cogeneration Project to an acceptable level. ICG Ontario submitted that it has done so.

ICG Ontario rejected Board Staff's assertion that the credit rating of ICG Ontario will suffer in the event that the Cogeneration Project does not perform as well as anticipated. It submitted that the Board should accept the evidence of Mr. Falconer that, the credit rating of ICG Ontario may be improved by having ICG Ontario own and operate the cogeneration facility.

ICG Ontario identified several benefits which it believes will flow to the utility operations and consequently to the ratepayers of ICG Ontario. These include the net annual payment related to increased throughput; the assurance that Boise Canada will not reduce its throughput; and the potential strengthening of ICG Ontario financially as a result of which the credit rating of ICG Ontario may improve.

ICG disagreed with Board Staff and IGUA's submission that the benefit derived by the Cogeneration Project from the use of the utility income stream should be shared equally between the ratepayer and the shareholder. ICG does not see any rationale for providing a further benefit to the ratepayers as they are already being adequately compensated for the minimal risk.

ICG Ontario submitted that the most important aspect of the policy behind Article 5.4 which contemplates that non-utility businesses should be carried on outside of the utility is the avoidance of the possibility that the non-utility business will adversely affect the risk of the utility business. The Company believes that the problems with respect to possible cross-subsidization and efficient regulation can be resolved by proper accounting and reporting policies as proposed by ICG Ontario.

ICG Ontario submitted that contrary to Board Staff's assertions it has no incentive to present as pessimistic a forecast as possible. In fact, ICG Ontario believes that it would have an incentive to be optimistic with its projections so that it would not appear that the project is any threat to the utility operations. ICG Ontario contended that is has been neither conservative nor optimistic with its projections but simply attempted to be realistic.

ICG submitted that there was no reason why Mr. Marriott should have been required to respond to the question of how far the return on equity would have to fall before it became too low. That answer would have been speculative and would depend upon a number of circumstances including the extent of the equity investment in the Cogeneration Project. It submitted that the Board should not accept the criticism of Mr. Marriott as it is not justified.

ICG submitted that the evidence of Mr. Falconer should be preferred over that of Mr. Anderson and that the Board should find that a return on equity of 17.29% if the Cogeneration Project is outside ICG Ontario too low.

ICG Ontario submitted that the Board should not accept the proposition that the return on equity to the investor is irrelevant to the Board's recommendations.

If the Board is in favour of cogeneration, then the Board will be concerned with return on equity to the investor because without an appropriate return, investment will not be made in cogeneration projects.

With respect to the roll-out scenario, ICG Ontario submitted that the Board should accept the evidence at the hearing that this is not a viable option. Specifically, ICG believes that a roll-out could trigger recapture of the tax savings or may jeopardize the claim for CCA in its entirety.

## SEPARATION AND ACCOUNTING ISSUES

The parties to the hearing made submission on ICG's proposals regarding the separation and accounting issues on which the Board was asked to report by the Lieutenant Governor in Council. Several parties had recommended against the exemption to Article 5.4 of the Undertakings, these parties accordingly did not address the separation and accounting issues in detail.

### ICG ONTARIO

ICG Ontario agreed that the assumption of additional risk by the utility, and the risk of cross-subsidization would be avoided by the separation of

the regulated activities of the utility from unregulated activities either outside the utility company or as a legally separate entity. However, ICG Ontario submitted that the benefits of the proposed, unregulated, activity should be assessed against the additional risks.

In this case, ICG Ontario claimed that there will be no risk because of the separate Cogeneration Division that would be created with separate accounting mechanisms and inter-functional charging arrangements for management time and facilities used. It submitted that these practices and procedures should alleviate any concerns about cross-subsidization between the utility and the Cogeneration Division.

BOARD STAFF

Board Staff submitted that if the Board recommends to the Lieutenant Governor in Council that the Cogeneration Project remain in ICG Ontario, then the appropriate separation of the Cogeneration Division from the utility operations becomes important. Staff considered both the separation of costs and the reporting of these items in the context of ICG Ontario's rate hearings.

Board Staff had a few areas of concern with ICG Ontario's accounting proposals. They were:

a) The manner in which utility staff time spent on Cogeneration Division business was calculated;

b) The fact that some services had been performed by the utility for the Cogeneration Division but had not been billed for;

c) The fact that ICG does not propose to charge interest on the balances owing by the Cogeneration Division to the utility; and

d) The fact that no return component is included in the costs that are charged to the Cogeneration Division.

Board Staff submitted that:

a) a formalized procedure be implemented to ensure that all time spent by utility personnel on Cogeneration Division activities be accurately and completely recorded;

b) in the future <u>all</u> charges, no matter how minor, must be paid by the Cogeneration Division. Staff submitted that charges for staff services performed in 1988, directors fees and the "minor

amount" of office equipment still in rate base should be calculated and collected;

c) compound interest should be charged on the average monthly balance in any accounts which accumulate charges to the Cogeneration Division for goods provided or services performed by the Utility;

d) since Cogeneration Division is using assets that are included in the rate base (such as the office building, the computer equipment, certain office furniture) and on which the ratepayers pay a return. Staff submitted that in order to prevent cross-subsidization, staff submitted that the charges made to the Cogeneration Division for any asset which it uses that is also included in ICG (Ontario)'s rate base should contain a return component based on the current return on rate base found by the Board;

e) a signed Service Agreement between the Cogeneration Division and the utility would be of assistance in determining whether all charges are appropriately made.

Staff submitted that it is vital that the financial performance of the Cogeneration Project be monitored on an ongoing basis to ensure that it is not a threat

to the integrity of the utility and that this reporting should be done in a public forum. Staff set out a list of the types of information that, in its opinion, ICG should file in its main rates case.

Staff also submitted that the Board should be kept informed of the development of other Cogeneration Projects until such time as it is definitely determined that the Company will not be requesting permission to include them in the utility.

IGUA

IGUA submitted that if the Cogeneration Division became part of the utility operation, appropriate accounting procedures would be required in order to ensure the clear separation of utility and non-utility segments of the business. IGUA submitted that the complete financial details of the Cogeneration Division should be provided.

NSI

NSI submitted that if the Board recommended acceptance by the Lieutenant Governor in Council of ICG's proposed corporate structure and relaxation of Article 5.4 of the Undertakings, very stringent reporting requirements would be required. NSI stated that the Cogeneration Division should be required to make the

maximum public information available to facilitate assessment of risk to ratepayers in each rate case.

ICG REPLY ARGUMENT

ICG submitted that it has no particular difficulty with Board Staff's proposals with respect to the principle for accounting for services provided to the Cogeneration Division and with respect to an allowance for interest. It proposed that the scope of the services to be charged to the Cogeneration Division and the nature of any interest charges be developed in conjunction with Board Staff.

ICG, however, argued against adopting weekly time sheets in respect of time spent on the cogeneration project, the explicit inclusion of a "return component" to the amounts identified as services to the cogeneration project, and the execution of a "service agreement" between ICG and the cogeneration project. Instead, ICG proposed to standardize the way in which time spent on cogeneration matters is recorded and charged to the Cogeneration Division. On the issue of a "return component", it argued that the real issue is not whether the amounts charged to the Cogeneration Division include such amount but whether those amounts are reasonable. With respect to the "service agreement", ICG proposed that, since an agreement with oneself cannot be enforced, it would be

more appropriate to deal with such matters in a set of accounting policies developed in conjunction with Board Staff and reviewed by the Board at each main rate hearing.

On the matter of reporting policies, ICG termed as fair and reasonable Board Staff's proposal about the material to be filed with the Energy Returns Officer and the material to be included in ICG'S main rate case filings.